A SPECIAL MEETING

THE MONT PELERIN SOCIETY

1980 | 2020

JANUARY 15–17, 2020

FROM THE PAST TO THE FUTURE: IDEAS AND ACTIONS FOR A FREE SOCIETY

HOOVER INSTITUTION • STANFORD UNIVERSITY

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Why Choose Economic Freedom?

An Opening Conversation

George P. Shultz and John B. Taylor

John Taylor: Welcome to the Mont Pelerin Society meeting. Welcome to the eighty-eighth meeting since the Mont Pelerin Society started back in 1947.

George Shultz: There are a lot of people here tonight. When the Mont Pelerin Society was founded in 1947, there weren't too many people there.

John Taylor: This is true.

George Shultz: So, the point is, that it's now okay to be a fan of freedom. There was a time when it wasn't so popular.

John Taylor: That's so true. Well, maybe we're drifting back to one of those times. I don't know. The theme of this meeting is *From the Past to the Future: Ideas and Actions for a Free Society*. So, we're going to be talking about lessons. We're going to be debating ideas. And we're going to be determining actions for the future.

This is the fortieth anniversary of the 1980 meeting held at the Hoover Institution by the Mont Pelerin Society, which has its archives here along with those of Friedrich Hayek, Milton Friedman, and George Shultz. 1980 was also the year that Milton Friedman and Rose Friedman released their book and the TV program *Free to Choose*.

So, George and I thought it would be great to start the meeting with a discussion about the themes of freedom that the Mont Pelerin Society has done such a good job of promoting. We just finished a book. It's called: *Choose Economic Freedom*. We quote Milton Friedman so much that he appears on the cover along with George Shultz and me. I couldn't be in a prouder position. In fact, I couldn't be more honored to be on this stage with George Schultz. His contributions in government, academia, and the private sector are truly amazing. And I have the honor of seeing him often and discussing these ideas.

George Shultz: What I learned the most from was being in the United States Marine Corps.

John Taylor: Do you want to say anything more about the Marine Corps, sir?

George Shultz: Well, I'll say something about the Marine Corps. I remember in bootcamp at the start of WWII, the sergeant handed me this rifle. And he said, "Take good care of this rifle, it's your best friend. And remember one thing: never point this rifle at anybody unless you're willing to pull the trigger." So one reason the Marines are taken so seriously is everybody knows, we'll pull the trigger.

Now, I think the significance of this recent takeout of the terrorist is not understood very well, because it showed for the first time in a long time, after a whole series of Iranian provocations, including taking out our drone, knocking out a huge Saudi oil facility, and so nobody does anything about it. All of the sudden, somebody hits back. So somebody will pull the trigger. So let's not fix it so that everybody can see, we can't pull the trigger anymore. It's very important for the Iranians to know we'll pull the trigger.

John Taylor: Thank you. So, preserving and maintaining all kinds of freedom are important. Now we're going to talk more about *economic* freedom. That's in the book title, and we put a copy in your welcome bag. So, take a look at it when you can.

George Shultz: We should have sold it, John. That's the market, you know. You give it away, there's no market there.

John Taylor: So true again. What we thought we'd do is talk about good economic policy and bad economic policy and good results and bad results; how policy makes such a difference. There are lessons from the past for the future. We begin in the 1960s and maybe you could start us off, George.

George Shultz: Well, at that time, we had a really attractive and interesting new president, John F. Kennedy. And while I was on the other side, he was an interesting guy. And he wanted to so-called get the economy going again. And his Council of Economic Advisers, which had a lot of people on it that I knew well, including Bob Solow, who's a colleague at MIT, thought that under these circumstances, that we have something that deals with inflation. So they produced a concept called "guidelines," that would tell you how to do your prices and wages and so on. And I looked at this, and I said, "This smells bad to me. It's going to be the intellectual precursor to wage and price control. And that's a bad thing." So I organized with my colleagues at the University of Chicago a conference on guidelines. And we had a great group of people come. And the stars were Milton Friedman and Bob Solow, both Nobel laureates. So Milton gave the opening speech, and Bob followed. Milton said, "Inflation is always and everywhere a monetary phenomenon. Guidelines don't have anything to do with it." And Bob made the case. And in our book, we quote extensively both Milton and Bob as they make their case. But it was a very alarming conference in many ways for me, because people were very relaxed about the guidelines. They wanted them. And when I raised the question of raise and price controls, it was sort of a so-what attitude. So, while the conference was good, it was not reassuring to me. So I continued to worry.

John Taylor: And the worrying continued after the 1960s. And now you're in government, Budget Director, Labor Secretary, Treasury Secretary, and the president is Nixon, so what happens?

George Shultz: So, I become Director of the Budget, and all of the sudden I'm in a different world where we're worried about taxes and spending and so on. And when I was at the Council of Economic Advisers in the Eisenhower administration, Arthur Burns was the chairman. And he was a man of tremendous stature. Helmut Schmidt, Chancellor of Germany, called him the pope of economics. In other words, he's infallible. So, I take over as Budget Director, and I find that Arthur had arranged a bailout of a company called the Penn Central, a big financial company that had mismanaged its affairs. And somehow, through a reluctant David Packard and the Pentagon, he'd arranged this bailout.

And I said, “This is a crummy idea. They’ve mismanaged their affairs; they should pay a penalty.” And in the Oval Office, I’m arguing with Arthur, and I’m thinking, *what am I doing, arguing with Arthur Burns about financial markets?*

And in walks a guy named Bryce Harlow, who was the savviest political advisor. And he said, “Mr. President, in its infinite wisdom, the Penn Central has hired your old law firm to represent them in this matter. Under the circumstances, you can’t touch this with a ten-foot pole.”

So there as no bailout, and the Penn Central failed. And guess what happened to the financial system? It got stronger, because everybody realized all of the sudden, *hey, wait a minute. They didn’t bail these guys out. You’d better look at your hole card, better strengthen your balance sheet and so on*. So everybody worked at it. And it turned out to be a very positive, not negative, effect. So, it turned out that Arthur was not infallible after all.

John Taylor: So that person who wasn’t so infallible wrote this memo to Nixon, and you found it; it was in the archives, a remarkable memo from someone who was considered an extraordinarily good economist at the time. And what did he say?

George Shultz: Well, Arthur was really a fantastic economist, and he was a man with tremendous intellectual force. When he said something to you, you really swallowed. And he was a great friend of Nixon’s, the president. And I smelled wage and price controls coming, and so I made a speech called Steady as You Go. And the argument of the speech was, we have the budget under control. If we have a steady monetary policy, steady as you go, for that time, we will get inflation under control. And all of the sudden I lost, and I didn’t know why I lost so fast. But in the Hoover archives, which are amazing, I unearthed about four or five months ago a letter from Arthur Burns to President Nixon. And Arthur argued that the economy has changed, and it has changed so much that orthodox policy won’t work anymore, so you’ve got to do something different. How about wage and price controls? So I realized why I lost. I lost because of that letter. And it was a catastrophe. It was a particular catastrophe, because when they were imposed, inflation was coming down anyway, and international commodity markets were weak. So it looked like it worked. And people were intoxicated. And I was scared to death. But anyway, that’s what happened.

John Taylor: Well, I agree. It was a disaster. In fact, you soon left the Treasury, did other things, and Nixon left of course as well.

George Shultz: So, what happened, John, was it looked like it worked. He got reelected handily. And then things started to change. And all of the sudden, the wage and price controls started to hit. And I found in my archives, things like people saying, “Hey, we got really great low meat prices, but we don’t have any meat.” “But now we have outrageous meat prices, but at least we have some meat.” So the market works, keeps working.

George Shultz: When I became Secretary of the Treasury, this whole administrative apparatus is reporting to me. And guess who’s running it? Don Rumsfeld and Dick Cheney. Wow. Anyway, we all talked about it, and we said, “You know, we should loosen this thing up and start getting rid of these things.” And we checked that out with the President, we told him, “Look, inflation has not been eliminated, it has just been suppressed. And you sort of take the suppression off, and you'll begin to see it percolate a little bit." So we warned him. But it turned out it percolated. So, he got alarmed. And he decided to do something about it. The only funny thing about it is we were meeting in the Oval Office, and Herb Stein, who was really funny, was head of the Council of Economic Advisers said to him, "Mr. President, you can't walk on the water twice." The water was the wage and price freeze that he put in that went so well. And Nixon said, "Herb, you can if it's frozen." I thought, "Oh, my God, that's where we're going."

Anyway, he re-imposed wage and price controls over my advice. So I went to him, I said, "Mr. President, you did this, I think it's wrong. I think it's going to hurt the economy. So you've got to find yourself a new Secretary of the Treasury."

And he said, "Well, you know George. Brezhnev is coming in a couple of months, and you've been running the economic relationship with the Soviet Union. Won't you stay until that happens and run the economic side?"

So I agreed.

And then Brezhnev comes, and Nixon, who didn't like economics very much, wanted to take Brezhnev to California and have big strategic discussions. So I said, "Why don't you stay here with your economics group, and you could take over Camp David for the weekend? Everybody will feel flattered by that?"

So, we go up to Camp David, and I listen to the Soviet economist talk about the Soviet economy. And they didn't realize… They knew I didn't understand Russian, so they could talk freely. And somehow or other, they didn't understand that my interpreter could understand what they were saying. So I got a full readout on what was wrong with the Soviet economy: a lot. So when I came back as Secretary of State, that information helped me. So, I'm glad Nixon persuaded me to stay a little while longer.

John Taylor: So, after Nixon resigned, I went into government at the Council of Economic Advisers. Ford was president. And we were still suffering from what you just described. In fact, President Ford had a tried solution. He still wasn't listening to Milton. His solution was we would just wear buttons.

George Shultz: Whip inflation now.

John Taylor: Yes, the buttons said, "Whip Inflation Now," and Ford presented the idea to a joint session of congress; the idea was simply that people would wear these buttons and inflation would go away. I think most of Ford's economic advisers were appalled by the whole thing. Of course, they didn't say that at the time. But just watching a video now of the Ford speech before a joint session of congress reminds one of that failed approach to economics. I show it to my Econ 1 class every year. It's a remarkable thing, and I think it illustrates the process through which this type of bad economics become a clear failure. And was occurring throughout the seventies right into the Carter Administration.

In any case, I think everybody here now gets the picture that bad economics, leads to bad policy, leads to bad results. So maybe we should see if it works the other way? In 1980 other ideas and people came into the picture, philosophies were different, and things changed. Tell us a little bit about that part?

George Shultz: Well, Reagan came along, and when we took office, I organized his economic team. When we took office, inflation was in the teens. That's the result of wage and price controls. The economy was going nowhere. I might say the Cold War was as cold as it could get, because the Soviets had invaded Afghanistan, and Jimmy Carter had cut off all relations. No contact at all. So that's what we inherited. And we sent Reagan advice, and the paper with the advice is reprinted in the book, *Choose Economic Freedom*. By about the third day in office, he abolished the Jimmy Carter controls on energy. Remember Jimmy Carter's gas lines? Abolished that. And there was still a residual bureaucracy to administer controls. He ended them. And he cut tax rates.

And he also did something else. Arthur Burns's letter said classical policies wouldn't work. And Paul Volcker was over there at the Fed. He had been my undersecretary when I was secretary. I knew Paul well. And Paul was using orthodox, classical, Milton Friedman-like monetary policy. And that was the right thing to do, and I thought so and Reagan thought so. And he took a long-range point of view toward this. And I remember people running into the Oval Office saying to him, "Mr. President, Mr. President, it's going to cause a recession. We're going to lose seats in the midterm election."

And Reagan nodded and smiled, and he put a political umbrella over Paul Volcker. And Paul told me, the late Paul Volcker was a good friend. He said, "I remember lots of times when the press would serve up to the President a question that invited him to attack the Fed, but he never took the bait." He took a long-term point of view. This is something you've got to do. And we did have a recession, we did lose seats, but by the end of 1982, inflation was under control and was clearly going to stay that way. And the removal of regulations and the tax cuts they put in took hold, and the economy took off like a bird.

John Taylor: So, good economics led to good policy, led to good results. That's the story, right? This story continued into the eighties, into the nineties, but as your story indicates, it's not easy. It is a struggle. How do you get these ideas into action? The actions must be part of the story. It's not just the ideas, it's getting them applied.

George Shultz: You also have to stick with them, because sometimes the short-term effects of a policy change cause difficulties. And you have to say, okay, that's something you have to bear with. And I give Reagan a lot of credit. I thought it was just the finest hour in domestic policy to put the political umbrella over Paul Volcker and let monetary policy work, even though the short-term effects were tough.

John Taylor: So, I came back into Washington after this period at the start of George H.W. Bush Administration. And to indicate some of the struggles that we had, consider the idea of "revenue enhancements," a euphemism for tax increases that were part of a compromise solution to reduce the budget deficit. You'll remember that. I had the job of calling people to say, "Hey, maybe revenue enhancements were okay." On my call list was Milton Friedman. So, I'm in my office in Washington, the Council of Economic Advisers, and I get Milton on the phone – he was out here at Hoover – and, before I said anything, he said, "John, I know why you're calling. And the answer is no. And by the way, get back out here fast. Washington is corrupting you." That's exactly what he said.

So, it's not easy. There is always a struggle. We kept with it through the nineties and into the start of the 2000s. But then what happened? I do not think we stuck with it, and with a monetary policy favoring an interest rate that was too low for too long and with a return to bailouts, we had a Great Recession. And now there is a question of where do you think things are going in the future?

George Shultz: Well, I think it's quite obvious if you look at factual material, that access to economic freedom, markets work. And government control doesn't work very well. That's the reality. But that idea is being attacked all over the world.

And here is Chile, I remember so well they gave a program to us when I was at the University of Chicago and said the Chilean economy was in a mess. They said, "Would you run an aid program in Chile?" We said, "We don't know how to run an aid program. We know how to teach economics." So there developed a scholarship program. We sent one of our best teachers down to Chile to identify students and professors who would give us honest evaluations. And we had a stream of Chilean economists come to the University of Chicago. And then Chile changed, and Allende was thrown out and Pinochet became the head. And he didn't know what to do either. Does anybody around here know how to economy? And our Chicago boys put up a hand and said, "We know how to do it." And so, he let them do it. And they produced the only really good economy in Latin America in the 1980s, it was sensational.

And then I'm Secretary of State, and I find that the Chilean constitution says that every ten years you've got to have an election for a new president. And this was coming up. So we started to put that out and Pinochet bought it, because he figured, *we'll have a ballot, I'll be the only person on it, no problem*. So that started. And then things began to boil. And it became obvious that the opposition had real roots. And I was afraid that he would stimulate violence. And that would be an excuse to intervene and cancel the election. We had a very good ambassador down there. We found that Castro had sent arms down to Chile. We intercepted them, and they never got there. But he was trying to do the same thing – create violence so there'd be an excuse to cancel the election. But anyway, the election was held and Pinochet lost. He was the only guy on the ballot, and he lost. Terrific.

So Chile had both an open, democratically elected political system and a very successful open economic system. And look what's happening now. Chile is in turmoil. And I think it's one of the most troubling things around the world, John, that the ideas worked, have been there, and people are objecting to them. And I think it's a problem we need to confront and think about carefully.

John Taylor: Yes. And Chile is one of the focuses of this Mont Pelerin Society meeting in a session with Axel Kaiser and Ernesto Silva and with commentary from Arnold Harberger, one of the Chicago boys. But of course, it's not just Chile. It's their neighbor next door and many other countries.

George Shultz: It's worldwide. It's all over the place. It's here. Everyplace.

John Taylor: And it's a very important issue. When Mont Pelerin Society began, it was a struggle simply to put good economic ideas out there when they were a minority of ideas. But then, as you just described, the late seventies and eighties had Reagan, Thatcher, Deng Xiaoping, and things began to change. And now it looks like we got the struggle again. The job may now be more difficult than ever. What I'm reading from this history is: good economics, good policy, good results – bad economics, bad policy, bad results. If we could just explain that to people. It's not just the ideas. It's people like you bringing the ideas into action.

George Shultz: John, you mentioned a few people. And I keep thinking to myself the importance of leadership in a country, in organizations of any kind. The leader makes a huge difference. You mentioned Reagan, Thatcher. In Russia, we had Gorbachev. And then we had Lee Kwan Yew. We had Nakasone in Japan. We also had Jiang Zemin in China. They were all great leaders. And I had the chance to interact with them, and boy, they were smart. They were sensible. And they could get done what they wanted to get done. They knew how to do it.

John Taylor: Well, that's what we need, and that's what we're going to be working on. And I think we're now going to just thank you, George, for a remarkable remembrance.

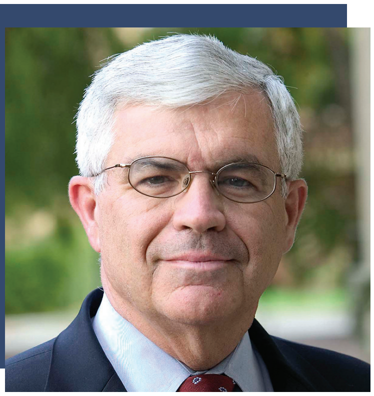
GEORGE SHULTZ

FORMER SECRETARY OF STATE, HOOVER INSTITUTION

George P. Shultz is a native of New York City and graduated from Princeton University in 1942. After serving in the Marine Corps (1942–45), he earned a PhD in industrial economics at the Massachusetts Institute of Technology (MIT). Shultz taught at MIT and, in 1955, served as a senior staff economist on President Eisenhower's Council of Economic Advisers. In 1957, he joined the faculty of the University of Chicago Graduate School of Business, where he became dean in 1962.

From 1968 to 1969, he was a fellow at Stanford's Center for Advanced Study in the Behavioral Sciences. He was appointed US secretary of labor in 1969, director of the Office of Management and Budget in 1970, and secretary of the Treasury in 1972. From 1974 to 1982, he was president of Bechtel Group. Shultz served as chairman of President Reagan's Economic Policy Advisory Board (1981–82) and as secretary of state (1982–89). In 1989, he received the Presidential Medal of Freedom, the nation's highest civilian honor.

After leaving office, Shultz rejoined the Bechtel Group as director and senior counselor. He also returned to Stanford as a professor of international economics at the Graduate School of Business and as a distinguished fellow at the Hoover Institution. Shultz is the author of numerous books and articles, including *Turmoil and Triumph: My Years as Secretary of State* (1993), *Issues on My Mind* (2013), and *Learning from Experience* (2016). He is one of the editors of *Beyond Disruption: Technology's Challenge to Governance* (2018), and his most recent book is *Thinking about the Future* (2019).



JOHN B. TAYLOR

HOOVER INSTITUTION

John B. Taylor is the Mary and Robert Raymond Professor of Economics at Stanford University and the George P. Shultz Senior Fellow at the Hoover Institution. He is widely recognized for path-breaking research in macroeconomics, monetary economics, and international economics. He served as senior economist on the President's Council of Economic Advisers from 1976 to 1977, as a member of the council from 1989 to 1991, and as under secretary of the Treasury for international affairs from 2001 to 2005.

Taylor is currently president of the Mont Pelerin Society and recently served on the Eminent Persons Group on Global Financial Governance created by the G20. He received the Alexander Hamilton Award and the Treasury Distinguished Service Award at the US Treasury, and the Medal of the Republic of Uruguay for his work in resolving that nation's 2002 financial crisis. His book *Global Financial Warriors* chronicles his policy innovations at the US Treasury. He received the Truman Medal for Economic Policy for extraordinary policy contributions, the Bradley Prize for economic research and policy achievements, the Hayek Prize for his book *First Principles*, and Adam Smith Awards from the National Association for Business Economics and the Association of Private Enterprise Education. His most recent book is *Reform of the International Monetary System*. Taylor received Stanford's Hoagland Prize and Rhodes Prize for excellence in undergraduate teaching and the Economics Department Distinguished Faculty Teaching Award. Taylor received a BA summa cum laude in economics from Princeton and a PhD in economics from Stanford.

An Introduction to Free to Choose 1980 to 2020 and the Network

Robert Chatfield
Free to Choose Network
January 16, 2020

There is a linkage between The Mont Pelerin Society and Milton Friedman that does not immediately come to mind. Arron Director, Friedman's brother-in-law, had met Friedrich Hayek at the London School of Economics in 1937 and helped arrange for Hayek to join the faculty at the University of Chicago. Although in the background, Director was a steady ally of Hayek and a very close friend of George Stigler. Stigler, along with W. Allen Wallis and himself, Friedman labeled the Three Musketeers.

In 1975, Bob Chitester approached Wallis – then Chancellor at the University of Rochester - to participate in a National Symposium on Technology and Society, which he was organizing in Erie, Pa, in partnership with Donald Alstadt, President of the Lord Corporation. Wallis was also Chairman of the Corporation for Public Broadcasting and was surprised to find Chitester, then President of WQLN in Erie, was a self-taught classical liberal.

They both were concerned that PBS had not provided a conservative/libertarian response to John Kenneth Galbraith's series The Age of Uncertainty. Chitester expressed the desire to produce that response. Wallis proposed Milton Friedman as host and by phone introduced Chitester to Friedman. In January 1977, Chitester met Milton and Rose Friedman in San Francisco, and the adventure that became Free to Choose began.

The rest is not yet history. Bob Chitester embarked on a lifelong journey to bring the ideas, and then the legacy, of Milton Friedman to millions around the world. These ideas illustrate the vitality and effectiveness of voluntary exchange under the rule of law.

Free To Choose was the first step, but few realize that concurrently in partnership with Clay LaForce, the Free To Choose Network captured over 15 hours of discussions with Friedrich Hayek and has a portfolio of over 500 hours of film featuring many heroes of the freedom movement including former MPS presidents Buchanan and Becker, as well as a 3-hour biography of Sec. George Shultz.

Beyond his storytelling genius, Bob Chitester's greatest strength was his ability to build relationships beyond the rudimentary. In this essay, Chitester provides a fresh perspective on his relationship with the Milton and Rose Friedman with a theme of "Milton, Rose, Me, and Poetry." From their first meeting to the final Memorial Services for Rose, you can learn how this poetic relationship evolved.

For over 35 years, Free To Choose Network has continued to provide expanded reach for many free-market advocates. This Mont Pelerin meeting is the official launch for the latest endeavor: "Free To Choose Under 2", where the original ten programs have been painstakingly edited down to two-minute, timeless episodes. Think of these as supercharged Milton Friedman made for today's Internet attention span that can be used in college courses and help a new generation discover some old truths.

ROBERT CHATFIELD

FREE TO CHOOSE NETWORK

Robert Chatfield serves as president and CEO of Free to Choose Network (FTCN), a global media organization, taking the helm from founder Bob Chitester in July 2017. Prior to joining FTCN, he was CFO of Fluid Imaging Technologies, a manufacturer of scientific instruments. For the previous ten years, Chatfield ran his own business as a merger and acquisition advisor to private companies. Chatfield also worked in corporate finance roles with Banknorth Group (now TD Bank) and Polaroid Corporation.

Starting his career with the nonprofit Pioneer Institute, a market-oriented research institute based in Boston, Chatfield has maintained a proactive role in academia for twenty years, teaching as an adjunct faculty member for many organizations. Chatfield is currently affiliated with Syracuse University's online MBA program and Suffolk University's finance department, where he earned his MS in Finance. Chatfield is a lifelong learner, community servant, and an adventurer. He served a one-year visiting professor assignment at Suffolk's campus in Dakar, Senegal, and has participated in several humanitarian missions with Rotary International.

Milton, Rose, me and Poetry

Robert Chitester
Free to Choose Network
January 16, 2020

What was the source of Milton Friedman's success? He was a unique blend of scientist and salesman. George Shultz musically highlighted his scientific approach with a song about theories supported by facts which you can see in this video https://www.youtube.com/watch?v=A4blUppCNlM or read what he said:

"A fact without a theory is like a ship without a sail. Is like a ship without a rudder, like a kite without a tail. A fact without a theory is as sad as sad can be. But if there's one thing worse in the universe it's a theory, I said a theory, I mean a theory without a fact."

Milton himself gave some credit for his success to his disciplined avoidance of personal attack when debating Ideas. In an interview I asked him about his ability to disagree without being disagreeable (also on a video)

Chitester - Over the years I've watched you calm down a debate by saying, "go slowly, go slowly, urging the participants to control their emotions and think carefully. Is that a personality trait, is that something you were born with or did you train yourself to do that, to maintain civility and avoid ad hominin attacks?
Friedman – "In a way I'm inclined to say yes. In the following sense. Way back when we were in Washington during the New Deal. I was at the National Resources Committee. I, at one point in a meeting with Faith Williams, who was a woman at the Bureau of Labor Statistics - we were cooperating on this project of a study of consumer purchases. At any rate, at one of these meetings I lost my temper, and I accused her of ill faith or something and I later discovered I was wholly wrong. And that had a very big impression on me. And I decided I was never going to let that happen again."

To those I would add his curiosity.

His interest in everything.

His twinkle in the eye "let's go slowly," questioning that led to numerous break through public policy ideas.

The search for truth.

For the winning ideas that improve human well-being.

For emerging order through nearly infinite voluntary agreements of individuals.

But let's also keep in mind, this search for truth also includes intuitive assessments of what consciousness perceives as reality.

As Fred Rogers would sing in “Sometimes People are Good”
https://www.youtube.com/watch?v=ro2qQuWUEs0

Sometimes people are good,
And they do just what they should.
But the very same people who are good sometimes,
Are the very same people who are bad sometimes.
It’s funny, but it’s true.
It’s the same, isn’t it for me and…

Fred Rogers at his best. Can anyone deny the truth of those thoughts? Do we not admire the creative way Fred introduces children to a very complex idea in a simple way?

The impact of Friedman on human society was from transferring his scientific wisdom to others through his instinctive talent for storytelling.

Two days over 43 years ago, on January 14, 1977, thanks to an introduction by W. Alan Wallis, then Chancellor of the University of Rochester, at an apartment on the northeast corner of Jones and California streets in San Francisco, I met Milton and Rose Friedman.

I was then President of the public TV station in Erie, PA, which I had founded ten years earlier.

That evening I read two poems to the Friedmans, hoping to expand their understanding of “who” I was. I had no idea poetry was already a part of their life. Their son David had memorized a large portion of Rudyard Kipling’s poetry and had authored some himself.

My goal was to persuade them I had the skill and artistic sense necessary to complete the ambitious project I was proposing. And I was also hoping to impress Rose. Alan Wallis had advised me, “to get Milton to participate you must convince Rose.”

The first poem uses a moral quandary to start us thinking about the meaning of life.

Traveling Through Dark
By William Stafford

Traveling through the dark I found a deer
dead on the edge of the Wilson River road.
It is usually best to roll them into the canyon:
That road is narrow; to swerve might make more dead.

By glow of the tail-light I stumbled back of the car
And stood by the heap, a doe, a recent killing;
She had stiffened already, almost cold.
I dragged her off; she was large in the belly.

My fingers touching her side brought me the reason her side was warm;
her fawn lay there waiting,
alive, still, never to be born.
Beside that mountain road I hesitated.

The car aimed ahead its lowered parking lights;
Under the hood purred the steady engine.
I stood in the glare of the warm exhaust turning red;
Around our group I could hear the wilderness listen.

I thought hard for us all – my only swerving –
Then pushed her over the edge into the river.

I had read *Capitalism and Freedom* before meeting them and had picked up a few of the key ideas. With this and the following poem I emphasized choices and being free to choose long before we decided on a title for the resulting TV series.

Hay for the Horses
By Gary Snyder

He had driven half the night
From far down San Joaquin
Through Mariposa, up the
Dangerous mountain roads,
And pulled in at eight a.m.
With his big truckload of hay behind the barn

With winch and ropes and hooks
We stacked the bales up clean
To splintery redwood rafters
High in the dark, flecks of alfalfa
Whirling through shingle-cracks of light,
Itch of haydust in the sweaty shirt and shoes.

At lunchtime under Black oak
Out in the hot corral,
-The old mare nosing lunchpails,
Grasshoppers crackling in the weeds-
“I’m sixty-eight,” he said,
“I first bucked hay when I was seventeen.
I thought, that day I started,
I sure would hate to do this all my life.
And dammit, that’s just what
I’ve gone and done.”

Despite the farm hand's claim to the contrary, I think the economic way of thinking leads me to conclude he did not really "hate" doing farm work.

In February 1977, the Friedman's agreed to proceed with the creation of a TV series, which became "Free To Choose." In the fall of 1977, Milton came to Erie at my request, to speak to the Rotary Club and help me show my Board of Directors and the local community, the project was moving forward.

I had the pleasure of introducing Milton and in doing so emphasized his curiosity by reading the following poem.

Overland to the Islands
By Denise Levertov

Let's go – much as that dog goes,
intently haphazard.
The Mexican light on a day that
'smells like autumn in Connecticut'
makes iris ripples on his black gleaming fur
– and that too is as one would desire –
a radiance consorting with the dance.
Under his feet rocks and mud, his imagination, sniffing,
engaged in its perceptions - dancing edgeways, there's nothing the dog disdains on his way, -
nevertheless he keeps moving,
changing pace and approach but not direction –
'every step an arrival'.

Milton started his speech by turning to me and saying, "Bob, thanks for that introduction, but I didn't know you thought of me as a dog." My heart stopped, then he smiled, the audience laughed, and I relaxed.

I often associate Milton with Robert Frost's poem "The Road Not Taken." Not in the context of his scholarly work in economics, which was in the mainstream of economic thought, with his ideas influencing scholars for decades to come.

Where Milton stood above all his contemporaries was applying his inventiveness, his curiosity, his creativity to the development of new ways to address critical public policy issues.

The Road Not Taken
By Robert Frost

Two roads diverged in a yellow wood,
And sorry I could not travel both

And be one traveler, long I stood
And looked down one as far as I could
To where it bent in the undergrowth;

Then took the other, as just as fair,
And having perhaps the better claim
Because it was grassy and wanted wear;
Though as for that the passing there
Had worn them really about the same,

And both that morning equally lay
In leaves no step had trodden black.
Oh, I kept the first for another day;
Yet knowing how way leads on to way,
I doubted if I should ever come back.

I shall be telling this with a sigh
Somewhere ages and ages hence:
Two roads diverged in a wood, and I -
I took the one less traveled by,
And that has made all the difference.

When Milton died in November of 2006 I made every effort to help Rose endure her grief. She lived almost three more years, dying in August 2009. At Memorial Services for her at Hoover Institution and the University of Chicago, I reflected on her life and shared the following poem to emphasize how much she missed Milton in those final years.

For Sale
By Robert Lowell

Poor sheepish plaything,
organized with prodigal animosity,
lived in just a year -
my Father's cottage at Beverly Farms
was on the market the month he died.
Empty, open intimate,
its town-house furniture
had an on tiptoe air
of waiting for the mover
on the heels of the undertaker.

Ready, afraid
of living alone till eighty,
Mother mooned in a window,
as if she had stayed on a train
one stop past her destination.

Every occasion I spent time with Rose after Milton died, she would say in her grief, "I want to be where Milton is."

Milton helped all of us understand freedom, economics, politicians and ourselves, through his concise and witty quotations, squeezing new meaning from common phrases. The following poem illustrates the power of words to convey far more than any picture.

A Box of Pastels
By Ted Kooser

I once held on my knees a simple wooden box
in which a rainbow lay dusty and broken.
It was a set of pastels that had years before
belonged to the painter Mary Cassatt,
and all of the colors she'd used in her work
lay open before me. Those hues she'd most used,
the peaches and pinks, were worn down to the stubs,
while the cool colors –violet, ultramarine –
had been set, scarcely touched, to one side.
She'd had little patience with darkness, and her heart
held only a measure of shadow. I touched
the warm dust of those colors, her tools,
and left there with light on the tips of my fingers.

And I use this poem to remind people, were it not for the wealth created by free market capitalism and the personal freedom it supports there would be no discretionary income to support the arts which contribute so much to our happiness.

Finally, I share with you, Milton's favorite poem. The basic message is: no free society, no kingdom, no empire, no dictator, no tyrant can change the immutable laws of the Copybook Headings. When we let them erode, when our children no longer learn them, when they no longer come readily to mind, societies crumble.

Sayings like:

"sticks and stones will break my bones, but words will never hurt me,"

"a penny saved is a penny earned,"

"actions speak louder than words."

are an important way to reinforce commonly held guides to a happy life.

I was surprised to learn (quote) “actions speak louder than words” originated in the 1600s, projecting a concept consistent with our understanding of the economic way of thinking.

The Gods of the Copybook Headings
By Ruyard Kipling

AS I PASS through my incarnations in every age and race,
I make my proper prostrations to the Gods of the Market Place.
Peering through reverent fingers I watch them flourish and fall,
And the Gods of the Copybook Headings, I notice, outlast them all.

We were living in trees when they met us. They showed us each in turn
That Water would certainly wet us, as Fire would certainly burn:
But we found them lacking in Uplift, Vision and Breadth of Mind,
So we left them to teach the Gorillas while we followed the March of Mankind.

We moved as the Spirit listed. They never altered their pace,
Being neither cloud nor wind-borne like the Gods of the Market Place,
But they always caught up with our progress, and presently word would come
That a tribe had been wiped off its icefield, or the lights had gone out in Rome.

With the Hopes that our World is built on they were utterly out of touch,
They denied that the Moon was Stilton; they denied she was even Dutch;
They denied that Wishes were Horses; they denied that a Pig had Wings;
So we worshipped the Gods of the Market Who promised these beautiful things.

When the Cambrian measures were forming, They promised perpetual peace.
They swore, if we gave them our weapons, that the wars of the tribes would cease.
But when we disarmed They sold us and delivered us bound to our foe,
And the Gods of the Copybook Headings said: "Stick to the Devil you know."

On the first Feminian Sandstones we were promised the Fuller Life
(Which started by loving our neighbour and ended by loving his wife)
Till our women had no more children and the men lost reason and faith,
And the Gods of the Copybook Headings said: "The Wages of Sin is Death."

In the Carboniferous Epoch we were promised abundance for all,
By robbing selected Peter to pay for collective Paul;
But, though we had plenty of money, there was nothing our money could buy,
And the Gods of the Copybook Headings said: "If you don't work you die."

Then the Gods of the Market tumbled, and their smooth-tongued wizards withdrew
And the hearts of the meanest were humbled and began to believe it was true
That All is not Gold that Glitters, and Two and Two make Four

And the Gods of the Copybook Headings limped up to explain it once more.

As it will be in the future, it was at the birth of Man
There are only four things certain since Social Progress began.
That the Dog returns to his Vomit and the Sow returns to her Mire,
And the burnt Fool's bandaged finger goes wabbling back to the Fire;

And that after this is accomplished, and the brave new world begins
When all men are paid for existing and no man must pay for his sins.
As surely as Water will wet us, as surely as Fire will burn,
The Gods of the Copybook Headings with terror and slaughter return!

Forty-three years after meeting Milton and Rose, reflecting on our relationship I am humbled by the faith they had in me and proud to have managed to justify their faith. I hope our work together will continue to help advance human freedom and well-being for decades to come.

BOB CHITESTER

FREE TO CHOOSE NETWORK

Bob Chitester is the founder and executive chairman of Free to Choose Network. After completing his BA and MA degrees at the University of Michigan, he created closed-circuit educational television systems and launched a public television and radio station, which he headed for sixteen years. He created numerous public television programs, including Milton Friedman's world-changing 1980 series, *Free to Choose*.

Chitester also created *Stossel in the Classroom*, which morphed into Izzit.org, a source of educational videos serving more than 300,000 middle school and high school teachers. He started the Idea Channel, a library of more than two hundred recordings of intellectual discussions between the world's leading scholars, which includes sixteen Nobel Prize laureates.

Currently he is leading the effort to develop several community engagement activities associated with the upcoming series on the US Constitution, *A More or Less Perfect Union*, hosted by Judge Douglas Ginsburg. Chitester is also guiding the development of Capitaf, Milton and Rose Friedman's summer home in Fairlee, Vermont, as a venue for residential student colloquiums to discuss Friedman's public-policy ideas.

Removing Obstacles on the Road to Economic Freedom: 1947-1980

Eamonn Butler

The Mont Pelerin Society was liberals' response to the political ruin that had engulfed Europe before and during World War II. Its founders believed that this ruin was the dismal result of mistaken ideas. They committed themselves, not to political action, but to recapturing the intellectual battlefield.

In the event, the Society did more than merely keep European liberalism ideas alive; it deepened and spread liberal ideas across the globe.

That is a remarkable achievement from a body that exists mainly in the minds of its members—run by volunteers with only part-time office support. It is a loose association of people who believe in freedom and believe that ideas change the world. They disagree on the precise ends and means. But the diversity of their views is a mark, not of the Society's failure, but as its fruitfulness as a forum for debate.

It was in Cambridge, to which the London School of Economics had been evacuated during the Second World War, that Hayek started asking himself how liberalism could ever be rebuilt. He thought that liberalism had to be made relevant to the times. He knew that this required the talents of isolated liberals to be brought together. So, he proposed the creation of an international liberal intellectual society.

After much effort, thirty-nine participants, from ten countries, made it to Mont-Pèlerin in 1947. They included thinkers from economics, law, history, political science, chemistry, philosophy, business, journalism and public policy. Their agenda was daunting: monetary instability; unemployment; public goods; security versus freedom; regulation; the very nature of a liberal order. And the big question of the time: Can Germany ever be rehabilitated?

Even though the participants shared a liberal outlook, there were deep disagreements on these difficult questions. "You're all a bunch of socialists!" stormed Mises famously, when others suggested that progressive income taxes were justifiable.

Such disagreements made a final communique hard to agree on; but Lionel Robbins eventually produced the *Statement of Aims* that is used even to this day. "The central values of civilization are in danger," it warns. Research is needed—to redefine the functions of the state; reaffirm the rule of law; combat the misuse of theory; and safeguard peace and freedom.

"The group," it concludes, "is politically unaligned," existing only to promote the free society by "facilitating the exchange of views" among minds with broad ideas in common. All in all, it has not done such a bad job.

EAMONN BUTLER

ADAM SMITH INSTITUTE

Dr. Eamonn Butler is director and cofounder of Britain's leading free-market policy think tank, the Adam Smith Institute, and a leading author and broadcaster on economics and social issues. Westminster insiders look forward each week to his wry online commentary on politics and politicians. Butler has received many awards in recognition of his long-term commitment to furthering the market economy, such as the UK National Free Enterprise Award and the Freedom Medal of the Freedoms Foundation at Valley Forge. He is honorary secretary of the Mont Pelerin Society.

Butler commissioned and raised the funding for the statue of the economist and philosopher Adam Smith (1723–1790), that stands in Edinburgh's High Street. He has appeared in many TV and film documentaries on policy issues, such as *Brexit: The Movie*, and produced the two-part historical documentary *Secrets of the Magna Carta*.

Butler is a prolific author of books on a wide range of subjects, from economics to psychology and politics. These include easy-to-read introductions to the economists Milton Friedman, F. A. Hayek, and Adam Smith, and a short explanation of how markets work, called (modestly) *The Best Book on the Market*, which he wrote to be "so simple that even politicians can understand it."

Milton Friedman: The Early Years[1]

In April 1947 Milton Friedman embarked upon a "junket to Switzerland ... to save liberalism," as his colleague George Stigler jokingly put it.[2] The two men were among a small group of intellectuals invited to attend the inaugural meeting of the Mont Pelerin Society. Now considered one of the founding institutions of global conservatism in the 20th century, the Mont Pelerin Society was the brainchild of Austrian economist F.A. Hayek. Once a widely respected scholar, Hayek's stock had fallen as economists turned to Keynesian and mathematical approaches in the aftermath of the Great Depression. Hayek was now famous not for his economic analysis, but for his 1944 *crie de coeur* against state planning, *The Road to Serfdom,* penned in London as German bombs rained from the sky.

But now Hayek wanted to move from writing books to starting institutions that could shape the political climate. Hayek recognized that liberalism – the creed of limited government and open markets in which he deeply believed – had lost political purchase. In an era of social democracy, not to mention communism and fascism, the 19th century ideals of republican government seemed bound for extinction. Were it to survive, liberalism needed to be re-thought, top to bottom. Hayek was not alone in this reckoning. The first efforts to conceptualize liberalism for the modern era had arisen in Paris in the 1930s, following the publication of American journalist Walter Lippmann's *The Good Society.* This was the moment that first got Hayek thinking about an "international organization of liberal economists."[3] The concept had a dry run of sorts in the *Colloque Lippmann*, a 1938 gathering of mostly European economists. War intervened in any follow up, and postwar, Lippmann had lost his taste for conservative politics and ideas.

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[1] Adapted from *The Last Conservative: The Life of Milton Friedman* (forthcoming, Farrar, Straus, Giroux).
[2] George Stigler to Milton Friedman, December 20, 1946, in *Making Chicago Price Theory,* 49.
[3] Angus Burgin, *The Great Persuasion: Reinventing Free Markets Since the Great Depression* (Cambridge: Harvard University Press, 2012), 6.

Instead Hayek and *The Road to Serfdom* became the touchstones of another gathering, built upon the nucleus of the first. This time, it was clear more Americans would need to be included. Hayek reached out to those he knew personally – including Friedman's brother-in-law Aaron Director and George Stigler. The same discussions that led to Director's arrival at Chicago also resulted in the Volker Fund pledging financial support to Hayek's nascent society. A Swiss businessman also agreed to underwrite a portion of the costs. Thus Hayek was able to offer his American participants an all-expenses paid ten day trip to Europe to discuss political and economic ideas. Although he had two young children at home and had hardly settled into his new job, it was not the kind of invitation Friedman would decline. He had, in fact, never left the country. The Mont Pelerin Society would be his first step into a wider world.

The trip was a significant undertaking; Friedman would be away from his family, and the University of Chicago, for six weeks. Rose took Janet and David to Nevada to stay with her sister, while Friedman traveled in the company of George Stigler. The two men first sailed across the Atlantic on the ocean liner Queen Elizabeth, disembarking in a London that Friedman recollected as "in a sad way two years after the war."[4] He was particularly struck by the rigidly controlled economy and limited food supplies, which contrasted unfavorably with the more dynamic black market in France.

After a brief stay in Paris, they traveled by train to the small lakeside town of Vevey, Switzerland, where a funicular railway pulled them up to the mountaintop hamlet of Mont Pelerin. The conference was held in the *belle epoque* Hotel du Parc, graced with a stunning chandelier in the lobby and views down to Lake Geneva from the front terrace. Here they joined

[4] Milton Friedman and Rose D. Friedman, *Two Lucky People: Memoirs* (Chicago: University of Chicago Press,1998), 158-160.

an eclectic group, including Director, Knight, Hayek, Lionel Robbins, philosophers of science Karl Popper and Michael Polanyi, and the praetorians of the Volker Fund.

Henry Simons didn't live to join the Mont Pelerin Society, but at that first meeting, it seemed as if he was nonetheless in attendance. Amid bridge, sight-seeing, and back to back sessions about the problems of the world, Friedman articulated a progressive view of classical liberalism that owed much to his deceased friend. In a discussion of the group's agenda, Friedman argued that "Liberalism is in a curious position, and on the downgrade. It is at times used as a defense of the status quo, instead of being dynamic and progressive. We want to make sure that our manifesto is concerned in the progress of man's welfare." Ventriloquizing Simons, Friedman continued: "We have to agree on the necessity for a positive approach." [5] Similarly, Frank Knight used Simons' exact words when he called fractional reserve banking "diabolically designed" and argued for 100% money, Simons' pet reform of the monetary system.[6] Director began the meeting with a carefully crafted address that emphasized the "humanitarian tradition of liberalism," yet noted serious conflicts "between what liberals consider the social interests and the results of free enterprise." The problem the society needed to address was that "the liberal had no solution to offer derived from their fundamental philosophy."[7] All this was very much in line with Hayek's goal to reformulate a more modern, forward-looking defense of capitalism.

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[5] "Discussion on Agenda, Etc., April 4, 4:30." Minutes of Discussion at Mont Pelerin Conference, April 1st-10th 1947. Box 5, Folder 13, Mont Pelerin Papers, Hoover Institution Archives. Recorded by Dorothy Hahn, the minutes are not a full shorthand, with some sessions going unrecorded. Rather than verbatim, the gist of remarks are captured. The notes were understood to be private and not for publication. Page numbers indicated when minutes were paginated.

[6] "Contra-Cyclical Measures, Full Employment, and Monetary Reform, April 7, 4:30," 6, 7. Minutes of the Mont Pelerin Society. Box 5, Folder 12, Mont Pelerin Papers, Hoover Institution Archives.

[7] "Free Enterprise or Competitive Order," April 1, 4.30, III, 3, 5. Minutes of the Mont Pelerin Society, Box 5, Folder 12, Hoover Institution Archives. Although included in meeting minutes, from their length and structure these remarks seem to be a written paper or address delivered by Director.

Not all meeting attendees agreed such a reformulation was necessary. Austrian economist Ludwig von Mises was a vocal dissenter, at one point declaring "you're all socialists!" and storming out of the room.[8] Mises was among a minority contingent who remained uncomfortable with any revision of liberalism that justified an expanded role for the state. He vigorously disputed the other attendees' emphasis on monopoly, asking "why do people attack the monopoly, and not the patent law, the tariff, etc?" Following the same logic, American journalist Henry Hazlitt averred, "The biggest problem of monopoly is of government created monopoly."[9] FEE representative Orval Watts took a similar hard line, arguing that "problem of [business] cycles has largely been caused by government," and criticizing unemployment relief, a policy supported by most other members.[10]

In this context, Friedman was undisputedly on the left side of the society. He also remained a keen internationalist. When Watts claimed there was "growing dissatisfaction in America with American intervention in Europe," Friedman shot back quickly "I don't think Watts's opinions are representative of the USA."[11] The jab showcased the palpable divide between the prewar conservatism of Watts – isolationist, moralist, rigid – and the more flexible, pragmatic, and progressive liberalism Friedman represented.

In general, though, Friedman eschewed philosophical discussion, preferring instead to propose and explain specific policies. He touted the idea of "progressive negative taxation," an updated version of his 1939 proposal for guaranteed minimum income, now linked explicitly to the tax system. In response to questions, Friedman argued this was "a policy which is in

[8] *Two Lucky People,* 161.
[9] "Minutes, Mont Pelerin Conference, Tuesday, April 1st, 4.30." Box 5, Folder 12, Hoover Institution Archives.
[10] "Wages and Wage Policy," Minutes of the Mont Pelerin Society, April 8, 9:30. Box 5, Folder 12, Hoover Institution Archives.
[11] "Present Political Crisis," Minutes of the Mont Pelerin Society, April 9, 8:30, II. Box 5, Folder 12, Hoover Institution Archives.

accordance with the liberal society. Expediency is merely an additional advantage." Even alongside this invocation of liberalism, Friedman continued to employ a strangely bloodless tone. Amplifying his thoughts about equality during a discussion of poverty, Friedman asserted "Men are not born equal… There are definitely people who cannot earn, in the marketplace, an income even that we could consider to be a minimum." But Friedman went on to discuss this vexing social problem in an engineering idiom, noting "Other people have to pay for this help. Therefore we have progressive taxation. No democratic society is going to tolerate people starving to death, if there is food with which to feed them."[12] Was this a good thing or a bad thing? Friedman presented it as a basic social fact, drained of ethical content. While Hayek had conceived the Mont Pelerin Society as a place to discuss fundamental questions of value, Friedman continued to favor exposition of means.

The first Mont Pelerin Society meeting provided a revealing window into churn on the American right. It laid bare a basic cleavage between those who wished to mount a full-throated, unapologetic defense of capitalism and the calmer, cleaner, self-consciously scientific and forward-looking vision of Friedman. At the meeting's end, the relationship between these two strands of conservatism was far from clear. Ideologues like Rand were sure that it was a fight to the death. And surely it was significant that the group ultimately settled on the anodyne moniker "The Mont Pelerin Society," because all other proposed names spurred irresolvable debate. The Mosaic character of the meeting also raised questions. The prophets had come down from the mountaintop, but would anyone read the tablets? How would the impassioned aristocratic tones of Hayek or the antiseptic scientism of Friedman and Stigler play in the emerging mass society

[12] "Taxation, Poverty, and Income Distribution," Minutes of the Mont Pelerin Society, Tuesday April 8th, 8:30pm, pp 1, 3-4, Box 5, Folder 12, Hoover Institution Archives.

of the postwar West? Ten years would lapse until Friedman attended another Mont Pelerin Society meeting. By then, he would approach these questions from a very different perspective.

JENNIFER BURNS
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Jennifer Burns is an associate professor of history at Stanford University and a research fellow at the Hoover Institution. The leading independent expert on Ayn Rand, she is author of the acclaimed biography *Goddess of the Market: Ayn Rand and the American Right*. Currently, she is writing an intellectual biography of Milton Friedman. At the Hoover Institution, she directs the annual Summer Workshop on Political Economy.

Burns received her AB in history magna cum laude from Harvard University, and her MA and PhD in history from the University of California–Berkeley. Burns has published articles on conservatism, libertarianism, and liberalism in the *New York Times*, the *Washington Post*, *Die Zeit*, *Quartz*, and numerous academic journals. She has also been a guest on both *The Daily Show with Jon Stewart* and *The Colbert Report*. Podcasts of her courses on American history are available through iTunes and on her website, jenniferburns.org.

Mont Pèlerin 1947[1]

Bruce Caldwell

Hoover Institution and Duke University

"It was purely accidental that we managed to get funds for this conference" (F. A. Hayek, Apr 4, 1947, "Discussion on Agenda, Etc.," Mont Pèlerin Conference).

Hayek Sets Up a Meeting[2]

It was in an academic setting that Friedrich Hayek first broached the idea of an international society that would bring liberal thinkers into contact with one another, at a February 1944 talk before the Political Society at King's College, Cambridge, with Sir John Clapham in the chair (Hayek [1944b] 1992a).[3] The lecture occurred just a month before the publication of the British edition of *The Road to Serfdom* made him, to his surprise, instantly famous. The fame (or notoriety, depending on one's reaction to the book) spread further following the publication

[1] This paper was prepared for the Special MPS meeting held at the Hoover Institution of Stanford University on January 16, 2020. I would like to thank the participants at Niall Ferguson's Hoover History Working Group for useful comments.
It is also the first draft of the first substantive chapter of volume 2 of my biography with Hansjoerg Klausinger of F. A. Hayek, hence the abrupt start and the Hayek-centric focus of what follows. Some of the people and events mentioned in this chapter were dealt with in more detail in the earlier volume, so are handled very briefly here.

[2] There currently are two good books in English on the Mont Pèlerin Society that discuss the initial conference: Hartwell 1995 and Burgin 2012. Plickert 2008 is also an excellent source, in German. Sadly a recent dissertation, Innset 2017, half of which focuses on the 1947 meeting, is rather a disappointment. The author knows little economics, has a presentist bias, and though he claims to offer a corrective to more ideologically driven accounts he consistently represents liberalism as the ideology of an upper class elite worried principally about redistribution and loss of power.

[3] The strange numbering in this citation is used to keep all references consistent with how they appeared in the first volume of the Caldwell-Klausinger biography.

of an American edition in September, a subsequent condensation by Max Eastman for *Reader's Digest,* and an event-packed publicity tour in the States the following spring to promote the book. On that trip Hayek had the opportunity to discuss the project with Henry Luhnow, the president of the William Volker Charities Fund, a Kansas City based foundation that under Luhnow's direction increasingly supported free market scholarship. Luhnow encouraged him to provide a more concrete proposal, which Hayek sent him in August 1945. Grandiosely if accurately headed "Memorandum on the Proposed Foundation of an International Academy for Political Philosophy Tentatively Called 'The Acton-Tocqueville Society'," it provided a rationale for the society, then talked about its activities: facilitating contacts among members from different countries through meetings, translating foundational and contemporary texts, establishing an international journal, and perhaps even setting up a permanent home. The price tag was a cool $500,000. It took Luhnow less than a month to turn him down (Luhnow to Hayek, Sep 7, 1945).[4]

Hayek kept up his efforts to spread the idea as the war wound down, arguing in an article in the popular press that such a society would assist the postwar reconstruction effort by helping reestablish western values on the continent ([1945, June 23] 1992a). But he also continued to press the case to individuals; indeed, he got into the habit of bringing it up whenever he was around people who might be interested. Another occasion arose in October 1945, when he went to Zurich to give a lecture at the University.[5] He met for the first time Albert Hunold, who was then the director of one of the Swiss banks. Hunold had already agreed to try to raise some funds

[4] Unless otherwise noted, the correspondence between Hayek, Luhnow and Loren Miller cited here may be found in the F. A. Hayek papers, box 58, folder 16 (FAHP 58.16).
[5] Hartwell 1995, 30, dates the encounter to November 1945, but Hayek's datebook for that year indicates that his trip to Zurich took place in October.

for a journal to be edited by Hayek's friend and wartime correspondent Wilhelm Röpke, who had arranged the introduction.

Hayek had known the German economist Röpke since their first encounters at the Verein für Sozialpolitik in the 1920s, and he was also one of the attendees at the 1938 Colloque Lippmann. Röpke had spent the war at the Institut de Hautes Études Internationales in Geneva. The Institut, a child of the League of Nations, had been founded in 1927 by William Rappard, a Swiss diplomat, and Paul Mantoux, a French economic historian, and from 1928 had been directed by Rappard. In the 1930s the Institut hosted both Hayek and Lionel Robbins for lectures (Hayek [1937] 1999, Robbins 1939), and from 1933 onwards provided a home for scholars escaping authoritarian regimes of various forms, among them Ludwig von Mises and Hans Kelsen, both of whom were forced to flee again when the Nazi conquest of France made even neutral Geneva unsafe, at least for the likes of them. Hayek's links to the men who had remained in Geneva were more than purely professional. He had sent and received messages from Vienna concerning family members and friends through Röpke and Rappard during the war.

Like Hayek, Röpke was concerned that the past thirty years of war and depression had everywhere undermined confidence in foundational western values and principles, and that the world was turning for solutions to collectivism, a trend that posed a lethal threat to Europe's cultural inheritance. Though an economist he had in his wartime writings focused additionally on the spiritual and moral dangers that he felt were threatening western civilization at its core (e.g., Röpke [1942] 1950; cf. Burgin 2012, 80-81). To signal its purpose of reclaiming and reconstituting the western heritage in all its dimensions, his journal would be called, simply, *Occident.* It would provide a forum for a renewed discussion of alternatives to collectivism for shaping the values and policies of Europe as it rebuilt after the war.

Röpke's putative financial backer, Albert Hunold, was a strange bird. Over a long and peripatetic career he had been a schoolmaster, had gotten a doctorate in English literature but ended up, briefly, as an economics professor, and had been everything from a ski instructor and radio announcer to the head of the Swiss stock exchange (Hayek, Bartley interview, Feb 10, 1983). Not himself wealthy, he was exceedingly well-connected. A year after their initial encounter Hayek passed through Zurich again, this time on his way back to London from his first post-war visit to Vienna. He met again with his Swiss friend, who was now in yet another post, serving as the chief spokesman for the Swiss watch industry. Hayek asked him about how plans for Röpke's journal were going, and was told that the funds Hunold raised were not sufficient to finance the journal, but still available. Perhaps Hayek could use them for a preliminary meeting of the society that they had talked about on his previous trip?

That, anyway, was the story as told by Max Hartwell in his history of the Mont Pèlerin Society (Hartwell 1995, 30). In his own account, Hunold said that only about half of the funds had been raised, but added that the journal was also abandoned because the publisher they had chosen had started another journal, *Kyklos*, whose neoromantic editor (Edgar Salin) offended Hunold's sensibilities. Hunold wanted to find another publisher, but Röpke demurred, so the idea of the journal was put on hold (MPSP 5.15). Hayek added still more nuance to the story, reflecting the viewpoint of his friend Röpke: that the plan collapsed when Hunold insisted on complete editorial control over the journal, which Röpke refused and which led to a break between the two men. In any event all this worked to Hayek's project's benefit, for it ultimately provided the seed money for the first meeting. Hayek enjoyed telling the story, because it involved him reconciling Röpke and Hunold so that the money could be repurposed. He apparently relished the irony that he brought together the two people whose joint actions later led

Hayek to resign the presidency of the Society and nearly caused its collapse (IB 119-20, Bartley interview, Feb 10, 1983). But we get ahead.

Having secured a promise of funds for the meeting itself, Hayek returned to his American benefactor at the Volker Fund. Their relationship had improved since his first attempt at fund-raising faltered. From the start Luhnow had wanted Hayek to find someone to write an American version of *The Road to Serfdom,* and in 1946 had financed a four-month trip to the United States for him to do so. Though there were some missteps Hayek ultimately succeeded in convincing Aaron Director to undertake what came to be called the Free Market Study, which he would execute at his new home in the Law School at the University of Chicago. Director moved there in fall of 1946, the same term that his brother-in-law Milton Friedman joined the Economics Department. Though Luhnow would never get the book he wanted out of Director, he would later surely take solace in realizing that his efforts helped to create what would soon be known as the Chicago School of Economics.[6]

Coming off this successful venture, Hayek once again approached Luhnow for support. He had evidently gained some skills regarding fund-raising technique in the interim. He began his letter by acknowledging the wisdom of Luhnow's earlier expressed concerns: "I am still slowly pursuing the idea of an Acton-Tocqueville Society, and I am now rather in agreement with you that before one attempts any more formal organization one should try to get the prospective members together for a discussion meeting to see whether sufficient agreement on aims and method can be established to make a more ambitious plan worth while" (Hayek to

[6] For a fuller account, see vol. 1, chapter 30. We will not enter here the stormy waters of what constitutes the Chicago School of Economics, and whether there was an "older school" associated with Knight and Viner and a "second school" associated with Friedman, Director and Stigler (not to mention a still newer one associated with, say, Becker and Posner), or when the term first started to be applied. Those interested in these matters might usefully consult Medema, manuscript.

Luhnow, Oct 28. 1946). He then noted that there was a prospect that certain individuals in Switzerland would finance the costs of the actual meeting. The only real stumbling block now was travel expenses, especially for the Americans he wanted to invite. Would the Volker Fund be willing to cover the traveling expenses, if not for everyone, then at least for the Americans? Only a week later came the very welcome reply: "We would have a definite interest in making a major contribution to defray the expenses of the American representatives to a preliminary meeting for an Acton-Tocqueville Society" (Luhnow to Hayek, Nov 4, 1946).

Next came a flurry of letters back and forth between Hayek and a variety of interested parties. Even a cursory reading shows that it was a very delicate balancing act; the whole thing could have collapsed at multiple crucial junctures. Hayek was adept at negotiating: he was ever the diplomat, but when it counted quite willing to make his position clear. Because the meeting would be held in Switzerland, Rappard and Röpke were key participants who needed fully to be on board. He sent a letter to each of them to make sure of their approval, and, doubtless recalling Röpke's reaction to Hunold's attempts to control the publishing of *Occident*, assured them that the funders had agreed to go ahead with "no strings of any kind" attached (Hayek to Rappard, Nov 23, 1946; MPSP 5.4). That certainly was true when he wrote, but as we will see, soon enough Luhnow began raising some uncomfortable questions.

Given the rhythms of academic calendars Hayek decided that Easter week, which in 1947 was in early April, would the optimal period for the meeting, so time was short. He had to figure out whom to invite and how word an effective invitation, one that would attract the key people to come. He sent a draft of a circular letter of invitation to Röpke and Rappard, soliciting their feedback. In December Hayek heard back from Hunold that the Swiss funds for the conference had definitely been secured, and so accordingly sent Luhnow a copy of the draft that included a list of the invitees. Before hearing back from Luhnow Hayek sent out the circular letter, dated Dec 28, to fifty-four people, noting the purpose and date of the proposed conference and the possibility of travel funds being available for those coming from America, and inviting a quick response (MPSP 5.4).[7] On December 31 he left for a two-week trip to Vienna.

While he was away a letter arrived at his LSE office from Luhnow. Characteristically blunt, he informed Hayek that he had gotten "a violent reaction" from certain Volker Fund directors about some of the names on Hayek's list. Though he did not identify who was objectionable, he summarized that "some of the reactions that I have had on one or two of your suggestions are such that I know the Directors of the Volker Charities Fund would not be interested in paying their travelling expenses anywhere" (Luhnow to Hayek, Jan 6, 1947). To resolve the situation he proposed that a screening committee of four or five people with impeccable credentials be formed to vet the recommendations, and the Volker Fund would then pay the travel costs for those from the States who passed the test. Any others would need to pay their own way.

This was, of course, potentially disastrous. Hayek had no idea of who was so objectionable to Luhnow and the other Fund directors, but in any event the invitations had already been tendered with an implied promise of travel funding for those in the States who accepted.[8] Equally important, if the meeting was to be held in April there simply was no time to

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[7] Hartwell 1995, 31, incorrectly states that there were 58 names on the list. Hayek sent at least some of the letters out prior to December 28. Frank Knight noted that his was postmarked Dec 22, and Harry Gideonse commented, "Must I ascribe it to the miracles of this technological age that it arrived here on December 27 and was dated on December 28?" (Knight to Hayek, Dec 31, 1946, FAHP, 76.24; Gideonse to Hayek, Dec 27, 1946, FAHP 74.6).

[8] Bizarrely, it appears that Hayek cabled Hunold from London on Jan 11, 1947, saying that "American traveling cost secured stop may I post definite invitations to maximum forty two with offer free say [sic – should be stay] mont pelerin april firs [sic] to tenth Hayek" (MPSP 5.4). This was evidently premature, but also raises the question: Who sent the cable from London for Hayek, who was in Vienna? Anyway, after he read Luhnow's letter he wrote to Hunold to let him know that in fact the funds had not been secured. Though Hayek still expected Luhnow to come

set up a committee, gather their suggestions, and then decide whose travel could be funded. We do not know how long the letter sat unread in Hayek's LSE departmental mailbox, but it easy to imagine a reaction of sheer panic when on his return he finally opened it. On January 17 he cabled Luhnow: "If you could provide travel expenses for the following eleven American members Brandt Director Friedman Gideonse Graham Hazlitt Knight Kohn Machlup Mises Stigler some of whom may not in fact be able to attend Vevey conference would appear secured and important opportunity to discuss Chicago investigation created. Letter follows Hayek." In the follow-up letter, dated the same day, he defended some of the people whom he thought might have met with disapproval (Brandt, Gideonse, and Kohn) and made some recommendations for a potential steering committee, but also made two key points: that the meeting would barely be worth having if the Americans could not come, and that if the meeting date were delayed the Swiss funding might disappear. Both points were true, but they also implied that Luhnow needed to make the decision about travel funding now, without the benefit of a steering committee. The tactic worked. In his next letter Luhnow agreed to fund the travel for all eleven people.[9]

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through, there was a chance he would not, and if that happened, he wondered whether it be possible to pay for some of them out of the Swiss funds (Hayek to Hunold, Jan 22, 1947, ibid.).

[9] Hans Kohn, a historian from Smith College, was the only one of the eleven named in the cable who did not ultimately attend. Burgin 2012, 101 states that in response to Luhnow's abrasive letter, "Hayek quietly excised the most offensive names from a subsequent version of the list." This is incorrect. There were six people from America on Hayek's original list whose names were not included in the subsequent cable. Two were journalists, John Davenport of *Fortune* and Max Eastman of *Reader's Digest.* They were not on Hayek's cable because if they came their way would be paid by their employers. This was indeed the case for Davenport, and though Eastman ultimately was unable to come, *Reader's Digest* sent and paid for its European correspondent, Paris-based George Révay, in his stead. We know from a letter that Hayek sent to Luhnow that two others, Henry Wriston, President of Brown University, and William Orton, an economist from Smith College, turned down the initial invitation (Hayek to Luhnow, Feb 5, 1947). Hayek attempted a second invitation to both people, but they again declined (FAHP 78.25; 80.22). Friedrich Lutz, at Princeton, declined because coming would conflict with his teaching obligations (Lutz to Hayek, Dec 28, 1946, FAHP 77.21), and the invitation sent to Howard Ellis of the University of California, Berkeley, got lost in the mail. By the time he heard about the meeting from Fritz Machlup, it came too late for him to rearrange his schedule (Ellis to Hayek, Feb 5, 1947, FAHP 73.23). No names were excised from Hayek's original list.

To his credit, Hayek also made clear to Luhnow that he should not expect any quick payoffs from the meeting.

> I neither expect immediate results nor believe that any efforts which aim at immediate results are likely to change the general trend of opinion. What seems to me most urgently needed is that those who are capable of gradually evolving a philosophy of freedom which will appeal to the people of our time, should be able to do so in collaboration and full knowledge of their respective efforts (Hayek to Luhnow, Jan 17, 1947).

Tension between those who wanted the Society to maintain a more public presence with respect to policy matters, and those who adhered to Hayek's original vision of simply bringing together scholars from many countries who would quietly work to reconstruct the foundations of a philosophy of freedom, would arise again and again in the early years of the Society.

As for Luhnow, he was not prepared to give Hayek an entirely free hand. He requested that invitations to join the conference be extended to eight more people, plus Leonard Read and Loren Miller as "observers." He also conjectured that Jasper Crane, an executive at DuPont Chemical whom Hayek had met on his 1946 trip, would come at his own expense if invited. Hayek was again in a bit of a jam, because in terms of hotel accommodations, he only had room for six more people. Luckily, two of the people listed had declined previous invitations, so Hayek sent invitations to six, then as people declined, added others. In the end the people on Luhnow's list who ultimately attended were the journalist Felix Morley; Leonard Read, F. A. "Baldy" Harper and Orval Watts, all from the recently-established Foundation for Economic Education (FEE); and Loren Miller from the Detroit Bureau of Governmental Research. Herbert Cornuelle, also at FEE, was a late addition. Regarding Crane, Hayek let Luhnow know that he was in a different category. The conference organizers had all previously agreed that invitations should only be extended to "people who are in the first place scholars and writers, in order to avoid any impression that the conference has been instigated by any business interests" (Hayek to Luhnow, Feb 5, 1947). But they also allowed that people who were acquaintances of the organizers could be personally invited as observers, and if this suited Crane, he could come. In the end he did not.[10]

Luhnow was not the only one providing Hayek with critical feedback on his choice of invitees. Both Ludwig von Mises and Karl Popper took strong, principled, and diametrically opposed stances on the matter. Mises sent Hayek a letter in which he noted having reservations about Brandt, Gideonse, Eastman, and especially Röpke, the last of whom he considered an "outright interventionist" (Mises to Hayek, Dec 31, 1946; FAHP 38.24).[11] Accompanying it was a four-page typed addendum titled "Observations on Professor Hayek's Plan" which laid out his objections with his usual uncompromising clarity. Attempts to stop collectivism had failed because its opponents had adopted middle of the road positions that appeared as reasonable compromises but in fact made matters worse. *All* problems attributed to markets by critics were in fact the result of interference with the market process. Perhaps his most pointed line was: "He who wants to preserve freedom…must not protest that he abhors laissez faire" – which of course

[10] Crane had written to Loren Miller in September 1945 about the importance of writing an American "bible for free enterprise," and wrote again in May 1946 after having had a long lunch with Hayek about how impressed he was with him. He would end up being instrumental in raising funds for the first American meeting of the Society, at Princeton in 1958. His relationship with Miller, Read, Hayek, and the Society is explored in Philips-Fein 2009, chapter 2. For his part, Hayek described Crane as "a nice and sensible person" (Hayek to Luhnow, Feb 4, 1947).

[11] As we saw in volume 1, Röpke had advocated Keynesian-style responses to secondary depressions back in 1931. Mises and Röpke had been together at the Institut in the 1930s, so were well familiar with one another's views. In his 1942 book, Röpke had advocated a "third way" in which "everything was balanced." To avoid competition becoming a "social explosive" it had to exist within a "sound political and moral framework" (Röpke [1942] 1950, 176, 179, 181.) All of this was anathema for Mises. For more on the sometimes fraught Mises-Röpke relationship, see Kolev 2018.

is just what Hayek had been doing since 1933. (Hayek's view was not the outlier; for example, virtually all of the liberals who had attended the Colloque Lippmann shared it, though they differed on what a renewed liberalism should look like.) For Mises, "Laissez faire does not mean: let the evils last. It means: let the consumers, i.e. the people, decide – by their buying and their abstaining from buying – what should be produced and by whom" (ibid). Mises shared the "Observations" with at least one other person, Henry Hazlitt, who was sympathetic to his views (FAHP 74.34). On the other extreme, Karl Popper thought that "it would be advantageous, and even necessary, from the very beginning, to secure the participation of some people who are known to be socialists or to be close to socialism" (Popper to Hayek, Jan 27, 1947). Though Mises hesitated in committing, despite their reservations both he and Popper ended up attending the meeting.

Finally, there were those who expressed concerns about calling the organization the Acton-Tocqueville Society. Having read Hayek's original 1944 piece proposing an Acton Society, Röpke had warned him that the name was barely known on the continent (Röpke to Hayek, Jan 2, 1945, FAHP 79.1). William Rappard later noted that, for those on the continent who knew them, their names "evoke not only the ideals of liberty…but also, perhaps on account of their noble birth and their Catholic faith, something reactionary" (Rappard to Hayek, Nov 29, 1946, FAHP 45.6). And though he did not attend the conference, Jasper Crane criticized the use of past thinkers because some would identify them with their specific countries rather than with their ideas, and in any case, the organization should be looking forward, not looking to the past. He suggested "The Forward Society" and various derivatives thereof; another possibility might be to name it after Prometheus, "the mythical giver of liberty to men" (Crane to Hayek, Mar 7, 1947, FAHP 73.1). The issue would come up again.

Luckily for Hayek's sanity, most of the work for the final organization of the meeting could be left in Hunold's capable hands – even his critics later unanimously praised his organizational skills. The conference would run for 10 days – as Hayek explained in his letter to attendees in March, this would allow for more interaction outside of the formal sessions, a critical part of the mission. Hunold's choice for the meeting venue, the Hôtel du Parc, on Mont Pèlerin near Vevey overlooking Lake Geneva (which the French and francophone Swiss refer to as Lac Léman), was ideal in many ways: in addition to the stunning views, it was centrally located (for the Europeans) and, being in a country that had remained neutral during the war, was undamaged and itself a sort of "neutral territory" for discussants from many countries. Hunold also arranged outings that have since become such an integral part of all Mont Pèlerin Society general meetings. On Thursday the group took cars along the lake to a site of considerable meaning and charm, the Château de Coppet where Madame de Staël held her famous salons in the company of people like the early French liberal Benjamin Constant (with whom she had two children). One imagines that Hayek took the opportunity to entertain his traveling companions with the story of another famous visitor to Coppet, the "megalomaniac visionary" Comte Henri de Saint-Simon, who went there to propose marriage to Madame de Staël, this because (as he told the wife he left behind) "the first man of the world ought to be married to the first woman" (Hayek [1941b] 2010, 193, 190).[12] She rebuffed him.

On Saturday the group travelled by train to Schwyz to visit a 17th century palace and the famous monastery and abbey of Einsiedeln, founded in the 10th century. As it was the Saturday before Easter, in addition to a tour the group listened to a chanting of the Salve Regina,

[12] Hayek wrote about Saint-Simon in "The Counter-Revolution of Science," an essay published during the war in *Economica.* For more on the essay, see volume 1, chapter 25.

witnessed the resurrection service, and were treated to an organ concert. For this particular outing Hayek was recruited to request permission for the group to come, which was graciously granted (MPSP 5.4, 5.6).

As the meeting dates approached there were plenty of last-minute details that required attention. Hayek's recently married secretary Dorothy Salter Hahn (her new husband, Frank Hahn, would go on to teach economics at Cambridge) came along to take notes at the sessions. Hayek worried about the fact that only two women, Hahn and Veronica Wedgewood, would be present (some wives also accompanied their spouses, but they did not attend the working sessions) and asked Hunold if he could think of others to invite, but nothing came of it (Hayek to Hunold, Feb 4, 1947, MPSP 5.4). Four people who were scheduled to attend were for various reasons unable to do so. The no shows were Luigi Einaudi, then a Governor of the Bank of Italy; Jacques Rueff, a Colloque Lippmann attendee who in 1947 was President of the Agence Interalliée des Reparations; Charles Rist, a French monetary economist and critic of Keynes who with Charles Gide wrote a text on the history of economic thought; and the German historian Franz Schnabel, author of a massive history of Germany in the nineteenth century. The final total was 39 conferees.[13] Unfortunately the hotelkeeper only reserved 35 rooms, and as it was Easter weekend, the place was filled to capacity. The organizers were assisted by Aaron Director's request to share a double room with Frank Knight, this in order to get an ensuite bathroom for

[13]A full list of the participants may be found in Hartwell 1995, 45-46. In the 1967 reprinting of his 1947 welcoming address, Hayek listed only 36, and Stigler 1988, 143, repeated this number, evidently drawing on Hayek's list. Hayek reduced the number from 39 to 36 because four of the people were supposed to be in the category of "observer," namely, Herbert Cornuelle, Henri de Lovinfosse, George Révay, and Felix Morley. Probably because of his prominence, Hayek included Morley on his list. To further complicate things, the editor of the 1992 *Collected Works* edition added Lovinfosse back in, but not the other two, bringing the number to 37. Innset used this number.

Knight. But three attendees (Morley, Cornuelle, and Henri de Lovinfosse) had to be accommodated in another hotel (MPSP 5.5).

The Participants

So who were the thirty-nine people who came to the first organizational meeting of the Society? Hayek's original list of invitees included (excepting Hunold) only academics and writers, and he knew nearly all of them, professionally, personally or both. There were in the first instance the Swiss-based hosts and their compatriots: Hunold, Rappard, and Röpke. Added to this was Hans Barth, a philosopher and sometime journalist from the University of Zurich who was an acquaintance of Röpke's. We might also include in the Swiss contingent Bertrand de Jouvenel, a French political philosopher and journalist who had fled France for the safety of Switzerland in 1943. Hayek had first met him in London after the war (Jouvenel to Hayek, Jan 1, 1947, FAHP 76.15).

Jouvenel had a colorful if checkered past. At age sixteen he began what would turn into a five-year affair with his famous stepmother, the writer Collette, and in the early 1930s he travelled across America with his then lover Martha Gellhorn, the novelist and war correspondent who later would marry Ernest Hemingway (Knegt 2017, 221-22). As was all too common in the interwar period, Jouvenel's own political journey was similarly peripatetic. A progressive intellectual in the 1920s – an early book was titled *L'Economie Dirigée* (Jouvenel 1928) – like many of his generation he was a critic of the nationalism that had led to the slaughter and destruction of the Great War, and accordingly a great advocate of European cooperation, in his case especially between France and Germany. In the 1930s he was frustrated by the French government's failure to institute national policies to combat the depression, and became increasingly enamored of the strong leadership of men like FDR and Hitler, the latter of whom sat for an interview with him. In 1936 he joined Jacques Doriot's Parti Populaire Français, the closest thing to a nationalist French fascist party, but resigned in 1938 at least in part to protest the Munich agreement that gave Germany the Sudetenland.[14] After the June 1940 armistice divided France in two, he continued to view and write about the prospects of a diminished France living under the tutelage of a robust, youthful, community-minded "New German Order" favorably; as one historian put it, he had been "seduced by the idea of an anti-bourgeois fascist youth revolution" (Knegt 2017, 225). During this period he worked with the German ambassador to the occupied portion of France, his old friend Otto Abetz, to advance the cause of Franco-German reconciliation. In his memoirs Jouvenel claimed that at the same time he was working as an intelligence officer for the Service de Renseignements de l'Armée Française. In November 1942 the Allied landings in North Africa led to the German and Italian occupation of Vichy, by which point Jouvenel had soured on his earlier vision and began supporting the local resistance. He was arrested and held by the Gestapo for two days, after which he went into hiding and, in September 1943, escaped across the border with his wife Helene (ibid., 53-58; Mahoney 2005, 10-12). He apparently had a dry wit. Leonard Read once asked Jouvenel if he understood any German: "He replied that the only thing he fully comprehended was during the war when the Germans said of him, 'He should be shot!'" (Leonard Read journal, July 3, 1949, FEE Archives).

So how did Jouvenel find his way to Mont Pèlerin? He did not need to go far: the village of Saint Saphorin where he settled is one of the towns at its base. While living there he finished

[14] Soucey 1998, Knegt 2017, 13-34 review debates among historians of France as to the nature and extent of French fascism. Jouvenel ended up being a test case of sorts. Accused later of having been a fascist, in 1983 he sued the historian who made the claim for libel. At the trial Henry Kissinger, Milton Friedman and Raymond Aron testified on his behalf. The court split the difference by finding in Jouvenel's favor but only awarding him a nominal amount in damages. As they were leaving the court, Raymond Aron had a heart attack, dying within hours (Knegt 2017, 20; Soucey 1998, 141).

his erudite and provocative tome *Du Pouvoir* (*On Power*), and at some point was befriended by Wilhelm Röpke (Jouvenel [1945] 1948). Jouvenel's remarkable book combined (sometimes speculative) history, ethnography, evolutionary metaphors, political philosophy, and much else, portraying power as an almost metaphysical force. He began by pointing out that the sort of "total war" that had been waged twice in the past thirty years would have been unimaginable in earlier times. What had changed to make such mass destruction possible? Throughout time authorities have always wanted power, the ability to command others, but were limited in the resources to do so. The power of kings was associated with their person. Representative government and the system of checks and balances were meant to challenge the prerogatives that attached to individuals, but they also brought with them new avenues for gaining and exercising power, now in the name of the nation rather than the king. Numerous cultural, economic and political changes in the 19th century – the growth of industrialization, urbanization, and in particular the gradual emergence of mass democracy – brought with them new tools. Chief among these were the ability of states to tax and to conscript their citizens, which provided untold new resources to exploit. Though still in the hands of a few, power was now spoken of as if it were in the hands of all the people, and therefore the old system of checks and balances was thought no longer to be necessary. Hayek would later summarize the danger that these developments posed in his laudatory review of the English translation of the book,

> …power has an inherent tendency to expand and where there are no effective limitations it will grow without bounds, whether it is exercised in the name of the people or in the name of the few. Indeed, there is reason to fear that unlimited power in the hands of the people will grow farther and be even more pernicious in its effects than power exercised by the few (Hayek [1948] 1992, 249).

Despite his troubling past, the messages in Jouvenel's new treatise would resonate with those about to gather in Mont Pèlerin.

Returning to the other attendees, the people to whom Hayek was closest were, of course, his old friends from the Vienna days, now living in the States, Mises and Fritz Machlup. But he knew almost all of the others coming from America as well. Frank Knight, Aaron Director, and Milton Friedman were by then all at the University of Chicago, which had been Hayek's home base for his 1945 trip and half of his 1946 trip. He had known Knight since meeting him in Vienna, this before his move to England, and Director had attended Hayek's seminar when he visited LSE in 1938 and had been instrumental in finding him an American publisher for *The Road to Serfdom.* Harry Gideonse, who by 1947 had become the president of Brooklyn College, had in 1939 published an extended version of Hayek's "Freedom and the Economic System" in a Public Policy series that he edited (Hayek [1939] 1997); Hayek had met with him twice when he passed through New York on his 1945 trip. Hayek may have encountered Frank Graham, an international economist based at Princeton, when he visited Oskar Morgenstern and Friedrich Lutz there on his American trips. The only American Hayek definitely had not met prior to the meeting was George Stigler, then at Brown University for a year but returning to Columbia in the fall.[15] He would teach there until 1958, when he moved to the Graduate School of Business at Chicago. Stigler had gotten his PhD at Chicago in the 1930s, writing under Frank Knight, and knew Friedman well from their days together there, during their war work in New York, and at

[15] Stigler 1988, 142 stated that he had not met Hayek before the meeting, but Hayek apparently knew of him early on: he was one of the people whom Hayek had recommended to Röpke to serve on the editorial board of *Occident* (Hayek to Röpke, Oct 14, 1945; FAHP 79.1).

the University of Minnesota, so though not based at Chicago he was very much a part of their contingent (Friedman and Friedman 1998, 53-54, 146-49).

There were other scholars who, like Machlup and Mises, had left their own countries in Europe at various points in the 1930s. Hayek was very close to two of them. He had known the Austrian philosopher of science Karl Popper since he had presented an early version of "The Poverty of Historicism" in his seminar at LSE in 1936. As we saw in the last volume, Popper and Hayek carried on an extensive correspondence during the war and Hayek had been instrumental in bringing Popper from New Zealand to LSE at war's end. Hayek had first met the Hungarian émigré chemistry professor and polymath Michael Polanyi at the Colloque Lippmann in August 1938, but he surely knew of his earlier essays criticizing Soviet planning (especially the planning of science) and such "men of science" in Britain as J. D. Bernal: Hayek and Polanyi plainly had the same enemies (see Polanyi 1940). Polanyi had left Germany in 1933 to take a position at the University of Manchester. Hayek had met (according to Mises, the ideologically suspect) Karl Brandt, an economist specializing in agriculture who had left Germany for the New School and later for Stanford, when he visited that university in 1946. They discussed the Acton-Tocqueville Society on that occasion (Brandt to Hayek, Dec 31, 1946, FAHP 72.36). Finally, there was Erich Eyck, a German lawyer and historian who had left Freiburg in 1938, eventually settling in Oxford. Given Hayek's various connections to Freiburg – his student Vera Smith had married Friedrich Lutz, who had gotten his degree there, and Hayek would stop in Freiburg to see Eucken when he took trips to Austria before the war – he probably knew him, too, and certainly knew of his work: he was someone whom Hayek had recommended to do an article for Röpke's planned journal back in 1945 (Hayek to Röpke, Dec 5, 1945; FAHP 79.1).

A chief goal of the conference was to introduce liberals from the various European countries not only to their counterparts in America, but also to each other. Britain was represented by three economists, all of whom were of course well known to Hayek: his closest friend and LSE colleague Lionel Robbins, Stanley Dennison of Cambridge, and John Jewkes of Manchester. France would have been well-represented had Rueff (another Colloque Lippmann alumnus) and Rist been able to come, but even without them there was the economist Maurice Allais and law professor François Trevoux. Italy would have had two representatives had Einaudi not canceled; the other was Carlo Antoni, a philosopher and historian. Though more were invited from the area, the Scandinavian countries fielded one representative each. Trygve Hoff, the editor of a liberal magazine named *Farmand* and fervent opponent of planning (Hayek had been working on getting a book of his translated into English just before the war began; see FAHP 75.7), represented Norway; Carl Iversen, an economist and political scientist, Denmark; and Herbert Tingsten, a political scientist who had also recently become the editor-in-chief of the Swedish newspaper *Dagens Nyheter,* Sweden. Hayek had visited both Copenhagen and Stockholm in January 1946, and saw both Iversen and Tingsten on the trip (Hayek to Röpke, Jan 17, 1946, FAHP 79.1). Finally there was Walter Eucken, Hayek's friend from the University of Freiburg and the only representative from Germany who had actually spent the war there.

The other category of people on Hayek's original list were "writers," principally members of the press and, again, mostly people he knew. There was Henry Hazlitt, by then an editor at *Newsweek,* whose glowing endorsement of *The Road to Serfdom* in the Sunday *New York Times Book Review* section got the American edition off to a strong start. John Davenport of *Fortune* magazine also attended, and he too had written an admiring review (Hazlitt 1944; Davenport 1944). As noted earlier Max Eastman, who had done the *Reader's Digest* condensation of Hayek's book, could not come, but was replaced by the European editor, George Révay. The Oxford-trained historian and sole female participant Cecily Veronica Wedgewood was an editor at the British weekly *Time and Tide,* which had been an outlet for a number of contributions by Hayek: in 1945 alone he published seven pieces there. Even though he had written books Hoff was not a professor, so he too belonged in this category, and Tingsten did some journalistic writing in his capacity as newspaper editor. The only person that Hayek did not know among the writers who attended was Felix Morley, who had been suggested by Luhnow.[16] Morley had previously been editor of *The Washington Post,* and in 1944 had helped found the magazine *Human Events.*

Someone who was not on Hayek's list and neither an academic nor a newspaperman was Henri de Lovinfosse, the founder of the blanket and cloth manufacturing firm S. A. Manta in Belgium. He told Hayek that he employed 1300 workers (Lovinfosse to Hayek, Mar 4, 1947; FAHP 77.19). A friend of Röpke's, he had only received an invitation from Hunold in March, probably with the intent of increasing the representation of conferees from European countries (MPSP 5.5). Karl Brandt visited Lovinfosse in Belgium on his way back from the conference, and praised him in a subsequent letter to Hayek: "He is a real liberal of the very best caliber; a progressive employer who has the most satisfied employees I have ever seen anywhere, because he uses his imagination and leadership for their benefit" (Brandt to Hayek, June 6, 1947).

And what about the men whom Luhnow had recommended be added, either as participants or observers, presumably to keep tabs on the meeting and report back to him but also, perhaps, to ensure that "real liberalism" was adequately represented? Surely the first among

[16] In a letter on Feb 5, 1947, Hayek told Luhnow that Morley was someone he did not know personally. This implies that he had met the others mentioned in the letter, which included Read, Harper, Watts, and Miller.

them, on paper at least, was Leonard Read, the President of the newly-established Foundation for Economic Education. Read had worked in California throughout the 1930s, and by spring of 1945 had reached the post of manager of the Los Angeles Chamber of Commerce, the largest in the States. With the war winding down he decided to leave there for the Commerce National Industrial Conference Board, an institution dedicated to educating Americans about the basic principles of economics, something he deemed essential in postwar America. After eight months he quit, finding their requirement to tell "both sides of the story" when it came to issues of economic policy too constraining. One of his jobs at the Board had been fundraising, and he came to know several influential and wealthy industrialists. One of these was David Goodrich of the B. F. Goodrich Company, who put him in touch with others of like mind. Read attracted enough funds to create an organization that would promote the study of economic principles in ways more congenial to his own and his backer's predispositions.

The Foundation for Economic Education opened its doors in March 1946. Its first offices were a couple of rooms in the Equitable Building on Park Avenue in New York City, where B. F. Goodrich was located, but by July had moved into a mansion estate about a half an hour north of the city, in Irvington-on-Hudson.[17] Read soon brought in Orval Watts, who had served as his chief economic counsel when he was at the L.A. Chamber of Commerce, as the chief economist, and Herbert Cornuelle to be his executive assistant. A little later Baldy Harper, a marketing professor and economist who had been teaching at Cornell, also joined the group. The story is

[17] As Read's biographer Sennholz 1993, 72-73, notes, high federal income and estate taxes, real estate levies, and the near impossibility of finding and keeping service personnel resulted in a buyer's markets for estates outside of New York after the war. The purchase price for nearly seven acres and four structures was $40,000. As an aside, Caldwell grew up in a house built on the grounds of a former estate on Long Island, William D. Gutherie's "Meudon," which had been sold to a developer then partitioned into two acre plots, one of which his parents bought.

told that Harper decided to leave Cornell after a trustee of the university had suggested that he remove Hayek's *Road to Serfdom* from his syllabus (Sennholz 1993, 64-73, Blundell 2015, 27; cf. Doherty 2007, 149-69; Nash 2006, 27-32).[18]

The most intriguing character among the foundation men was Loren "Red" Miller. One of the many hats that Luhnow wore was that of Chairman of the Board for the Civic Research Institute in Kansas City. Miller worked there, and soon after they met Miller began to influence Luhnow to turn the focus of the Volker Charitable Fund away from local projects and towards the support of free market causes. Miller later became the Director of the Detroit Bureau of Governmental Research, an agency that was part of the privately funded "good government" municipal reform movement, but he continued to be a key adviser for Luhnow. Even from that rather modest posting, it seems he had his hand in everything.

Thus Miller had been in audience when Hayek, on his *Road to Serfdom* tour, spoke before the Economic Club of Detroit. Impressed by Hayek's talk, he set up the initial meeting between Luhnow and Hayek. It was Miller who sent Hayek an encouraging letter after the Volker Fund initially declined to support the Acton-Tocqueville Society proposal (Miller to Hayek, Nov 10, 1945). He also helped Leonard Read raise the funds necessary to purchase the mansion in Irvington-on-Hudson for FEE. Hayek agreed to place Miller along with Read on the "advisory committee" overseeing Aaron Director's work on the Free Market Study. Herb Cornuelle, who Read hired to be his executive assistant and who came to the 1947 meeting, had worked for Miller as a trainee in Kansas City and later at the Detroit Bureau (Doherty 2007, 182-83; Hayek to Luhnow, Aug 26, 1946).

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[18] As Doherty 2007, 651, n34, notes, Baldy Harper in fact had a full head of hair. The nickname had been given to him by fraternity brothers in college, and it stuck.

In addition to Luhnow, Miller advised other big time funders of free market causes, among them J. Howard Pew of Sun Oil (co-founder with his siblings of the Pew Charitable Trusts in 1948) and Jasper Crane, recently retired from DuPont Chemical. Pew and Crane would go on to underwrite the *Freeman* magazine in the 1950s, FEE's most important outlet for advocacy. Miller also helped develop the people who would work in the foundations. Dick Ware was employed by Miller at the Detroit Bureau from 1946-56, and on leaving went on to run the Earhart Foundation. Through Miller's introduction, Ware (and Ware's wife) attended the 1949 Mont Pèlerin Society meeting (Doherty 2017, 180-83; Miller to Hayek, Apr 2, 1949; Ware to Hayek, Aug 5, 1949, FAHP 38.16).

Miller had multiple reasons to attend the first meeting. Luhnow could not attend, so he was there to represent him and to see whether the Volker Fund's monies had been well-spent. Aaron Director would be in attendance, so he could also inquire into how the (Volker-funded) Free Market Study was coming along. He also wanted to identify who among the various people in attendance were "sound," the sort who might be worthy of further support.[19] Friedrich Hayek would be among those who passed the test. In a year's time Miller would use the connections he had made with Director to start the ball rolling to bring Hayek to the University of Chicago. But again, we get ahead.

Hayek's Agenda

Even had the meeting at Mont Pelerin been a one-off affair it probably would have been worthwhile, given their fewness in number, simply to introduce liberals from a variety of

[19] Ludwig von Mises started teaching at NYU in February 1945, his salary wholly financed by outside funds. Though the exact sources of funding are obscure, at least part of it appears to have been paid by the Volker Fund. By 1946 Mises was speaking so frequently at FEE that they were required to list him as an employee. Mises was an ideal academic spokesman for their views. For more on this, see Hülsmann 2007, 845-51.

countries to one another. In his invitation acceptance letter, Milton Friedman remarked on "the number of names on your list that are unfamiliar to us" (Friedman to Hayek, Jan 2, 1947). Making those introductions was one of Hayek's premier goals.

But he also wanted to form a society, which was far more ambitious. Such an organization would require a statement of principles, a set of commitments that all members would need to agree to. Having witnessed the fractious discussion that took place among supposedly like-minded men at the 1938 Colloque Lippmann, he could not have been sanguine about the prospects for any sort of quick agreement. It was not that disputes were unhelpful, of course, or something to be avoided. The whole point after all was to begin the process of arguing out the finer points of how to constitute a new liberalism for the postwar world. But he did not want things simply to explode. The combination of strong personalities and strongly held beliefs (Mises and Knight come immediately to mind) made the danger a real one. Even were such obstacles overcome, people would need not just to agree to some statement of principles, they would need to commit to carrying out the goals of the organization, whatever they might be. But what should they be? Hayek wanted to get a discussion among leading liberal intellectuals going, but he knew that some people, and not just those from the foundations, wanted to have a more public facing society, one that would attempt to enter the public forum and shape policy debates. Finally, if a Society was formed, there would need to be future meetings. Such gatherings, and international travel to them, would require substantial outside funding, and Hayek had just seen how hard that was to come by. We know in the end that the Society was formed, but at the time the outcome was anything but certain. The commitment of the people involved must be credited, but also the direness of the situation they confronted. In the spring of 1947, the prospects for Europe looked very bleak indeed.

We saw in the last volume how horrific things were in central Europe as the war ended. The intensification of strategic area bombing in the last year, and the inevitable carnage and destruction that accompanied final military assaults, killed hundreds of thousands and reduced city after city to rubble. There were massive flows of desperate refugees fleeing war zones, soon to be followed by the forced exodus of ethnic Germans from newly liberated countries. Finally, there was all manner of retributive violence – murder, beatings, rape, expropriations, public humiliations – in some places carried out by the conquering military forces (especially in areas taken over by the Russians), in others by fellow citizens eager to punish collaborators. By 1947 things had improved, but pressing geopolitical concerns, economic insecurity, political instability, and a looming humanitarian crisis created a sense of hopelessness and with it the potential for further upheaval.

The chief problem was: What to do with Germany?[20] The eastern part of that country had been occupied by the Soviet Union, and the west by France, Britain, and the United States, though in 1946 the British and American zones were joined. For two years the foreign ministers of the four nations met, trying to resolve the issue of how to move forward. In broad terms the Soviets preferred a single unified country (which would evidently fall under their sphere of influence), and a continuation of reparations payments (which they supplemented with materials and capital goods that they had been systematically dismantling and shipping east). The other allies were less concerned with the reparations question (France excepted) than with the reconstruction of a new democratic German state with its own independent government (which would serve as a buffer against Soviet expansionism). Neither side wanted to budge, and until

[20] And also with Austria which, like Germany, was partitioned. We discuss the Austrian situation in some detail in volume 1, so will concentrate on Germany here. The next few paragraphs draw extensively on Bark and Gress, 1993, vol. 1, Part I; Judt 2005, chapters 3 and 4.

the question was resolved any sort of postwar recovery would be painfully slow, not just for Germany but also for the rest of Europe, which needed an economically viable Germany to help spur its own recovery.

The situation as it existed in the spring of 1947 was clearly unsustainable. Under the occupation regime, the allies were responsible for feeding the German people. Prices were controlled and a rationing system set up; it was essentially a command and control economy. The amount of food provided was insufficient to feed the population, but it was still costly for the allies. Britain, for example, was spending $80 million a year on the occupation while collecting only $29 million in reparations, causing Hugh Dalton, the Chancellor of the Exchequer, to observe that the British were paying reparations to the Germans, and this while bread was being rationed at home (Judt 2005, 123). The desperate conditions were further exacerbated by the weather. The winter of 1946-47 was brutal, the coldest since 1880. Roads and rail lines across the continent closed for weeks, throttling any sort of nascent recovery. There was a shortage of coal, and even when it was available it was difficult to deliver. The horrible winter was followed by a summer of drought, causing food production to fall in some places by 50% and more. The possibility of mass starvation was real.

The potential political consequences of the stalled situation were equally dire. The scholars and writers gathering at Mont Pèlerin were not sanguine, of course, about the nearly universal embrace by European governments of collectivist economic and social policies. But in 1947 their concerns went far beyond this. The Communist Party was gaining strength in places like Italy and France, where the potential for civil unrest grew with each strike and violent street demonstration. Meanwhile in occupied Germany and Austria the torpid pace and apparent arbitrariness across zones of the denazification process had become so widely resented that renazification was becoming the more likely outcome. It is no wonder that the leaders of the Soviet Union, whose minions were sowing unrest in multiple countries across Europe, were in no hurry to resolve the Germany question. The democracies to their west were under increasing pressure, and the longer they delayed, the greater the chances that the other allies would simply pull out, leaving all the spoils to them.

The situation was certainly well-understood by the Europeans gathering at Mont Pèlerin. Jouvenel would later put the matter precisely: "Doubtless you feel as I do that we are now hovering on the brink. The Russian menace from the outside, the Communist menace from the inside, and to defend Europe against this double offensive, the Socialists whose every idea tends to disorganize and weaken the Occident" (Jouvenel to Hayek, Mar 9, 1948, FAHP 76.15). Hayek had witnessed both the destruction, but also some hopeful signs, himself. In 1946 he visited Germany to give a lecture on themes from *The Road to Serfdom.* He entered the lecture hall through a small opening in a burnt-out pile of rubble, only to be greeted by a room full of eager students. This took place while the German translation of the book was still banned there (the Russians, as one of the four occupying powers, had demanded this), but on the trip he discovered that samizdat copies had been circulating. (He knew this because one he had come across was different in small ways from the original.) Clearly there was a thirst in Germany for ideas, if only the ham-fisted policies of the occupying forces could only be gotten out of the way. Later in 1946 and again in early 1947 he had visited Vienna, and was again horrified by what he saw. The Americans would have been less aware of all this, though as Milton Friedman recounted, the active black market that he and George Stigler encountered as they passed through Paris on the way to the meeting at least made it feel more vibrant than London (Friedman and Friedman

1998, 159). The conferees may have been meeting in luxurious surroundings, but their purpose was clear enough.

What they did not know was that the logjam was about to break. Soon after their meeting, American Secretary of State George Marshall returned from the Moscow meeting of the foreign ministers convinced that the Russians were simply biding their time in hopes of furthering the continued deterioration of Europe. Two months later the European Recovery Program, or Marshall Plan, was announced. It signaled not only America's willingness to assist in the rebuilding of Europe, the fact that the assistance was turned down by Moscow as well as other countries that would soon be within its orbit signaled the beginning of the Cold War. But in early April 1947, none of this could be foreseen.

If the main point of Hayek's agenda was to form a society that would provide the intellectual foundation for a new liberalism to confront the many problems besetting the postwar world, there was also an actual agenda of *topics* that he wanted to discuss. He was explicit about this, mentioning five in his invitation letter and again in his February letter to those who had accepted, with a tentative schedule of when each would be taken up in the first week. The proposed topics were: 'Free' Enterprise or Competitive Order, Modern Historiography and Political Education, The Future of Germany, The Problems and Chances of European Federation, and Liberalism and Christianity. Topics for the second week's sessions would be determined by the conferees. If the decision was positive to form a society, a statement of principles would also be formulated.

At 10 in the morning of April 1, the group gathered for the opening meeting. William Rappard gave a welcoming address, and in it asked why the modern world had rejected Adam

Smith's two great contributions, his sound economic analysis and demonstration of the links between freedom, constructive effort and wealth. Rappard's answer was that after thirty years of warfare and economic catastrophe the great mass of people were exhausted, caring more about security than either freedom or growth. The point of the conference was to start the process to reverse that trend: "May it prove to be for both continents the starting point of an intellectual, economic and political renaissance without which it would seem well nigh impossible not to despair of the future."[21]

Hayek followed with his own welcome, thanking both attendees and sponsors, and explaining how he had come to organize the conference. He emphasized his interest in bringing together not just people from different countries but also people in different disciplines, not just economics but fields like law, philosophy, and history. (He also apologized that, despite his best efforts, economists were over-represented, another perennial problem for the Society going forward.) He read out the names of people he invited who, though supportive of the goals, could not come, remembering also two people whom he had first discussed the idea with who had since died, Henry Simons and Sir John Clapham. He noted the presence of some sympathetic members of the press, but also emphasized that it was a private meeting so that anything said during the discussion was to be treated as off the record. He offered a brief rationale for each of the topics he had suggested for discussion, then proposed some procedures for the following days – the conference language would be English, a standing committee would be formed, time

[21] Papers prepared for the conference, like Rappard's, may be found in MPSP 5.12, while Hahn's notes on opening talks (when papers were absent) and on subsequent discussions may be found in MPSP 5.13-14. Rappard's paper also contains some methodological musings on the relationship between economic science and normative claims for liberalism.

would be devoted to assigning topics for the second week and chairs for all the sessions, any decisions about moving forward would be postponed until later (Hayek [1967] 1992, 237-48).

By modern conference standards the schedule was exceedingly civilized. Morning sessions did not begin until 9:30, afternoon sessions at 4:30, and evening sessions at 8:30. Thursday afternoon was devoted to the trip to Coppet, and after the Friday afternoon session the group did not convene formally again until Monday afternoon. Evidently all the free time was designed to promote interaction outside the formal meetings. Sessions would open with either a paper or remarks by whichever person had been given responsibility for it. Discussion then ensued, details of which were preserved in shorthand notes taken by Dorothy Hahn. Though remarks are attributed to individuals in her notes, these were not verbatim transcripts, but summaries of what each person said.

The afternoon session began with Hayek reading his paper, " Free' Enterprise or Competitive Order" (Hayek [1948] forthcoming).[22] The title was meant to emphasize the difference between a system of laissez faire, free enterprise, and his own preferred system, one in which the state and the legal framework work in tandem to make competition as effective and beneficent as possible. To be sure, even under free enterprise there was some minimal role for the state, which provided institutions for the protection of property and enforcement of contracts, and the prevention of violence and fraud. These though were not enough. Exploring what constitutes a proper competitive order was of course a chief goal of the conference, but clearly, and right from the start, by making the distinction he was distancing himself from Mises and

[22] This was the title that Hayek used in his mailings to the conference participants and in the agenda at the meeting, but the manuscript copy had "and" in place of "or," and that is the title it was ultimately published under in Hayek's 1948 collection, *Individualism and Economic Order.*

other advocates of laissez-faire, which presumably included people like Hazlitt as well as all of the foundation people.

Hayek emphasized too the importance of building the intellectual foundations of liberalism, and (provocatively, given his audience) quoted in full J. M. Keynes' famous passage at the end of *The General Theory* about the importance of the "gradual encroachment of ideas" that policymakers distilled from the writings of some "academic scribbler from a few years back" (ibid, xx).[23] Recognizing how effectively collectivists had staked out what appeared to be the moral high ground, Hayek insisted that what must be sought in a reconstituted liberal creed were "reforms which can be fought for by unselfish men, within a program for freedom" (ibid.).

His next step was to point out some problems with the free enterprise view that he opposed. Defending property rights was not enough, for example, without acknowledging that many of the benefits to society only occur when there is a diffusion of property as well. Parroting "freedom of contract" likewise accomplished little when both judge-made law and legislation altered contracts in ways that either restrained trade or protected incumbents. He noted how the concept of limited liability and other laws that applied to corporations aided the growth of business monopoly, and laws granting unions monopoly privileges and protections similarly assisted labor monopolies to form. Such ad hoc adjustments must be replaced by a legal framework that supports and bolsters the competitive order.

In addition to a proper legal framework, and in an implicit bow to Henry Simons over Keynes, he asked to what extent monetary management to forestall cyclical unemployment

[23] It is interesting to consider whether Keynes would have been on the list of invitees had he still been alive. Were he there some lively sessions would have been even livelier, but his presence probably would have been polarizing in ways that would have been unproductive.

might be pursued using a fixed rule. He also asked what provision should be made for the unemployed and the unemployable poor. About halfway through he added that,

> it seems to me highly desirable that liberals shall strongly disagree on these topics, the more the better. What is needed more than anything else is that these questions of a policy for a competitive order should once again become live issues which are being discussed publicly; and we shall have made an important contribution if we succeed in directing interest to them (ibid, xx).

He would get his wish in the discussion session to follow.

But first there were comments on Hayek's paper by Director, Eucken and Rappard, with Director's being the most extensive (or at least the most reported on by Hahn). Director like Hayek felt that the liberalism as currently conceived was incapable of responding adequately to real challenges that had arisen in the areas of monopolies and combinations, cyclical instability, and income inequality. Because there was no adequate liberal framework for addressing these issues, ad hoc remedies that caused their own problems were typically offered in their place. If Hayek's talk focused on remedies that involved the legal framework, Director's focused more directly on economics and on specific policy responses. Given that he was supposed to be working on the Free Market Study, a project that Hayek had negotiated and itself funded by the Volker Fund, his position in the line-up of speakers was probably intentional. Hayek wanted to showcase Director, and for his remarks to showcase both his abilities and the direction of his thinking.

Director performed his task admirably; his systematic presentation reads in parts like a summary of a mainstream introductory economics text of today on market failures and their possible remedies, though with a strong normative emphasis on his preferred policies. Monopoly power can be reduced by opening domestic markets to international competition, by using antitrust, and by changing patent law to reduce the length of time patents are protected. Legal prohibition of cartels and interlocking directorates was also essential, and in some instances the placing of limits on the size of firms might be warranted. Labor unions had through special legislation escaped limits on restraint of trade; such ad hoc legislation should be abolished. Echoing Hayek and his friend Henry Simons, Director thought that monetary rules should be used to prevent the cycle, with overall price stability as the guide (he did not spell out how that would work, but the idea of stabilizing movements in a constructed price index as a policy goal would not be welcomed by the Austrians). Previous attempts to reduce income inequality had resulted in a series of ad hoc measures that favored specific groups: minimum wage laws, price supports in agriculture, protection of specific trades, and so on, all of which should be abolished. But that did not mean that inequality should be ignored. The reduction of monopoly and support of education would help to mitigate it, but these needed to be supplemented by a program to improve the physical well-being of children from poor families, a progressive income tax system, and payments to low income households to ensure a minimum level of income.

Next up were Eucken and Rappard. The former emphasized the importance of having a system of laws in place to deal with monopoly rather than relying on the discretion of a legislative body, and wisely pointed out that firms do not fear nationalization (such monopolies are protected by the state) as much as they do competition. For his part, William Rappard stressed that liberals should be advocates of a free society, then pointedly noted that occupied Germany was anything but that.

General discussion waited until the evening session. The event might have been retitled "free enterprise *versus* the competitive order," or more simply "Mises versus the rest," though both Hazlitt and Miller made brief comments in support of Mises' positions, and "the rest" did not always agree with one another. Mises' arguments were predictably direct and pithy. We want the state, itself a monopoly, to control other monopolies, yet its own monopolies (like the US Postal Service or the New York subway system) make deficits, not profits. Why think it would do better in the area of monopoly management? Furthermore, why do people attack monopolies instead of the government policies – e.g., patent law, tariffs – that lead to them? Everyone opposes the corporate form, but it provides many benefits, and its only privilege is that the rights of its creditors are limited. As for income redistribution, the government was already taking 70% of the income of the upper classes (actually, at that time the top marginal tax rate in the US was around 90%, but he may have been estimating the total tax burden rather than the marginal one); where was the additional amount supposed to come from? As for tax policy, if taxes were simply low enough, one wouldn't even need to consider it.

Mises' approach was not successful. People wanted to discuss alternative policies, to find out which ones might best cohere with a liberal vision, not the reasons why policies were unnecessary. Both Hayek and Robbins tried to intervene in various ways, mostly to clarify the various positions under discussion, but at times things got testy. Harry Gideonse thought Mises was only answering the questions he wanted to answer, not those he was asked, and Frank Graham became even more agitated:

> Perfect freedom exists in the jungle. There is no law there. I think if we carry out the suggestions of Professor Mises we shall be in the jungle. We are here to find the middle

> road between the jungle and the jail… It seems to me that unless the government takes the active role to maintain competition, competition will not be maintained.

And so it went for the rest of the evening.

The session was sufficiently acrimonious that Veronica Wedgewood, who chaired the morning session the next day, said that she suspected the organizer had chosen to put a session on the uncontentious subject of "Modern Historiography and Political Education" with a woman in charge next in order to allow things to cool down. There might be something to that, though certainly another reason was that the first two sessions were on topics that would bring to mind the two missing members Hayek alluded to in his opening talk, Henry Simons and the English historian, and Hayek's closest friend at Cambridge, Sir John Clapham.

Hayek's complaints against the way history was being practiced were multiple. He had argued in his 1933 LSE inaugural address that the German Historical School economists had in their attacks on economic theory undermined public confidence in the science of economics, thereby opening up debates on public policy to all manner of proposals by quacks and charlatans. Their legacy was that the quest for scientific truth had been replaced by rampant relativism. It did not help that they had also supported Bismarck in his efforts to construct a welfare state (albeit this was designed to keep the working classes from embracing socialism) that was later reproduced in other countries. When he got to England Hayek encountered new narratives, many colored by the "scientific" Marxist notion that there were inevitable laws of history, chief among them that capitalism was inevitably doomed to destroy itself. Many advocates of planning argued that this made the adoption of a planned society imperative. Finally, those same critics of capitalism also argued that ideas were unimportant, just ornamentation when compared to the true movers of human history, changes in the mode of production and in the social relations of production. For Hayek (as for Keynes) this was nonsense; ideas were crucial. The Abuse of Reason project, to which he had dedicated his war years, was a critique of all these movements.[24]

Hayek's hopes for the session were not realized. Wedgewood mostly addressed the question of whether "serious" professional historians should cede the writing of the more popular kinds of history to generalists and propagandists. In her view, a competition among many historians would be the best guarantee against the misuses of history that were everywhere apparent. Both Erich Eyck (who spoke of the role of nineteenth century German historians in glorifying the Prussian crown, promoting the German Empire and destroying liberal doctrine) and Hayek (who questioned both value-free history and the notion of inevitable laws) tried to get things back on Hayek's preferred track, but much of the subsequent discussion turned on philosophical issues. Can history tell us what really happened, or does all history require selection and interpretation? How do, and how should, values enter into historical writing? What is a fact? Though such questions are interesting they were not what Hayek had in mind. He would have to wait until a later meeting, when the papers that were published in *Capitalism and the Historians* (Hayek ed., 1954) were first presented, to address the role of history in political education.

If the first session was predictably stormy, and the second vaguely disappointing, the third on "The Problem of Germany" ended up being the most memorable of the meeting, this due to Walter Eucken. It was a risk, Hayek knew, particularly for the Americans who would have known little about him, to invite a German who had stayed in Germany during the war to the conference (Hayek [1983] 1992, 192). They would not have known that, while in Freiburg, he

[24] See volume 1, part IV, "Fighting the Spirit of the Age."

had been vocal in his opposition to the University rector Martin Heidegger's acquiescence in the policies of the Nazis. They would have been ignorant about his participation in groups that criticized the autarkic economic policies of the Nazi regime, and of his circle's links to people like Dietrich Bonhoeffer and Carl Friedrich Goerdeler who were directly involved in the German resistance. All this had made his situation increasingly perilous at the end of the war. He was in fact detained for a couple of days by the Gestapo, but unlike his colleagues Adolf Lampe and Constantin von Dietze, he had been spared being tortured (Rieter and Schmolz 1993, 95-99). The Gestapo was not the only worry. In January 1945 Röpke had told Hayek that he had had no news "from W.E. since he cannot dare to write to me, but after the wholesale bombardment of his town I am extremely worried about him." Hayek was greatly relieved when he found out that Eucken, "about whose fate I was more concerned than anyone else's in Germany," had managed to survive (Röpke to Hayek, Jan 2, 1945; Hayek to Röpke, Jul 10, 1945, FAHP 79.1).

Röpke gave the lead talk, with the more senior, white haired and distinguished Eucken speaking second. Both emphasized that the occupation that followed the war essentially substituted one totalitarian regime for another. The effects of the various restrictions on the German population had been disastrous. As Röpke put it, it was "purely a matter of chance whether the worker gets enough to live or not." Both thought that currency reform and the lifting of controls on prices and production in the two western zones were the most important immediate steps to be taken, with the question of integration with the east to be faced later. (Röpke thought such integration less necessary, Eucken thought it important both politically and economically.)

What made Eucken's comments so powerful, even when read today, was his vivid description, made all the more poignant because delivered in calm and measured tones, of everyday life under the occupation.[25] Because rations were incapable of sustaining human life, an illegal black market had sprung up. Brandy was used for larger transactions, cigarettes for small ones, but for all that, almost all trade was local. Survival often depended on home production of potatoes and other vegetables. In a dig at Lord Beveridge, whose name had become associated with Full Employment as national policy, he deadpanned:

> Full employment prevails, and an enormous amount of work is done with very little result. In a short conversation I had with Lord Beveridge in a room below freezing point he asked, what do people do? My answer was that they spend their time going to the countryside to barter, with the return of an excursion being infinitesimal, such as single potatoes or a half a pound of grain. A thousand people thus achieve in a day what a single trader could do in a few hours.

His summary was bleak: "the German economy is undergoing a progressive primitivization and now corresponds rather to the economic system of the 6th and 8th centuries…At the moment Germany is half a corpse."

Eucken's moral authority was such that he was also the first speaker in the discussion session that followed that evening. Another contributor was the agricultural specialist Karl Brandt, who supplemented Eucken's claims by reviewing the decline in daily caloric intake for Germans since the war ended, concluding that the average was less than 1000 per person (of course not all were able to attain the average). Brandt also came up with the best line of the night

[25] Eucken understood but did not speak English well, so Hayek translated for his friend, a service that he later recalled fondly. See Hayek [1983] 1992, 192.

as he recounted the German response to the denazification program: “Germans talk of ‘Hitler’s 1000 year Reich: 14 years of Nazism, 986 years of denazification’.”

In reminiscences about the first meeting, both George Stigler and Milton Friedman recalled the affecting scene of Eucken taking meticulous care in the peeling of an orange, the first he had seen in years (Stigler 1988, 146, Friedman and Friedman 1998, 160). But as Friedman went on to add, “More important, he made vivid what it was like to live in a totalitarian country, as well as in a country devastated by war and by the rigidities imposed by the occupying authorities” (ibid.). If the people assembled needed a personification of what they were there for, and a depiction of the world they sought to avoid, Eucken provided it. He quickly became, in Hayek’s words, “the star of the conference.” Eucken was made one of the vice-presidents of the Society and would play a key role in recommending who from Germany should be invited to future gatherings (Hayek [1983] 1992, 192; Kolev, Goldschmidt and Hesse 2019, sec. 2.2).

The fourth session on “The Problems and Chances of European Federation” was the least successful of the week. Federation had been a topic of extensive discussion just before the war, driven in part by fears over German territorial aggression, and Hayek and especially Robbins had been active participants. Hayek raised the topic again at the end of *The Road to Serfdom,* in part because he feared that some sort of planning regime would be imposed by the victorious allies on the conquered territories, and in part because he thought that a federation could serve as yet another check on national governments, especially in the area of trade, e.g., by preventing them from pursuing protectionist policies. Though a few of those assembled still thought that some form of federation was desirable – Maurice Allais was perhaps the most enthusiastic – many did not, and virtually everyone (even Allais) agreed that current obstacles to it were formidable, rendering the discussion purely theoretical.

On the morning of Good Friday the topic turned, fittingly, to "Liberalism and Christianity." Hayek felt it was essential for the preservation of liberalism that its traditional antagonism towards Christianity be overcome. In Germany some of the most effective resistance to Hitler had been among active members of the church. Liberal political parties in most European countries were a dead letter, leaving those that had affiliations with the church as the only real alternatives to the social democrats and communists. Christian democratic parties leaned left-wing and progressive, to be sure, but if they could be convinced to look on certain liberal doctrines with more sympathy, there would be room for coalitions to grow. This is why right from the outset, in his August 1945 memorandum to Luhnow, Hayek spoke of bringing "Catholic liberals" into the Society.[26]

Hayek had originally planned to have someone sympathetic to his views lead off the discussion, like William Orton (his first choice), Franz Schnabel, or Michael Roberts, but none of them ended up coming to the meeting (Hayek to Orton, Feb 5, 1945, FAHP 78.25). So he turned to Frank Knight. This was a dicey call. In his letter accepting the invitation to the meeting Knight had warned Hayek against "snuggling up" too closely to the Catholic church, for "…if one says he is a Catholic and a Liberal, he either doesn't know what he is or places some other value or interest above telling the truth!" He then went on to disparage Orton, whose book he recently reviewed, noting "if he is a Liberal I certainly am not" (Knight to Hayek, Dec 31, 1946, FAHP 76.24). Was a civil discussion of the topic possible with Knight as the lead speaker?

It turned out to be one of the most interesting sessions (Felix Morley said at its end that it had been the most important so far). Knight's extraordinary opening remarks, imperfectly captured

[26] See volume 1, chapter 30.

by Hahn's notes, wandered far and wide. He began with the assertion that man is a religious animal, then asked whether liberalism could be formulated in a way so as to be compatible with religion. (He thought not.) Next he offered a broad historical tapestry, ranging from the early days of Christianity in the Roman empire through the Reformation to its role in America. The tensions he identified were well-known: that between the scientific search for truth no matter where it might lead versus belief that was dictated by faith, and that between the liberal's insistence on tolerance of divergent views versus the natural intolerance of heretical views exhibited by the religious.

Those conflicts all spoke against the chances of any easy reconciliation between religion and liberalism, but others spoke equally resolutely of its necessity. Once again Eucken drew on his own personal experience of life under a totalitarian system, arguing that there was no room for religious belief under such a regime, that only under a liberal system, precisely because of its dedication to tolerance, would Christianity be permitted to survive. While acknowledging the historical tension that had existed between the two, he asserted that in a world that seemed headed towards collectivism that liberalism was a friend rather than a foe of religious belief. Hayek of course agreed, adding in his comments that the antagonism between them was more an accident of history than essential, and noting that it was a writer in a Catholic magazine that had in England offered the first positive review of *The Road to Serfdom*. Frank Graham, who agreed with Knight that it was not so much a question of getting liberals to tolerate Christians as vice versa, made the telling observation that religious groups tend to support tolerance most fervently when they are in a minority and want to preserve their right to follow their beliefs. Given that in the current world the religious *were* in a minority, it might be possible for liberals to enlist their support. Eucken closed the session with a quiet and powerful affirmation of his own faith, rebutting the view that Christians would only come to liberalism out of self-preservation, and again recounting his own experience and those of then men he had known – some of them now dead – in the resistance:

> I am a Christian, and I want to say that from a purely Christian point of view I regard the competitive order as essential. If we consider what resistance there was in Germany, and the main victims of the Nazi oppression, these men were all liberals, but at the same time also Christians – Christians it is true without any formal dogma, but agreeing on man having an eternal life. It was that conviction that gave them their strength.

Despite some occasionally testy exchanges, the first week was deemed sufficiently successful that the assembled group decided to take the next steps. A committee of five was formed to write up a statement of principles. Perhaps predictably, the first try produced a document that was both too long and yet still missing bits that certain people wanted included. (Graham wanted it noted that liberals believe in the solidarity of all human beings; Friedman wanted it said that liberalism was a progressive philosophy with humanitarian aims.) At that point the drafting of the document was turned over to Hayek's great friend Lionel Robbins. It was a wise move. Robbins had very efficiently run the affairs of the economists at LSE before the war, then worked equally effectively beginning in late 1941 as head of the Economic Section in the wartime coalition government (Howson 2011, chapter 12). Asked if he could have a new statement ready the next morning, he said no, only by the next afternoon, and of course it was.

The new document was briefer – six points rather than ten – and, with the goal of achieving broad support, quite general. Everyone but Maurice Allais signed it.[27]

There were also discussions of the purposes of the Society (a forum for discussion and the dissemination of ideas; the possibility of a journal was also raised), its membership (to be determined by invitation), and, most entertainingly, its name. Suggestions ran the gamut from individuals (Acton-Tocqueville of course; Director suggested "the Adam Smith-Tocqueville Society") to descriptive (Morley came up with the rather laborious "International Society for the Study of Freedom in Society") to the classically heroic (Robbins offered "the Protagonist Society" and Popper "the Periclean Society"). When Karl Brandt proposed "the Mont Pèlerin Society" Popper responded, "That is meaningless." Whether it was meaningless or not might be debated, but it was sufficiently inoffensive that the group ultimately adopted it.

The Second Week – Economics and Russia

At the end of the first week the substantive agenda for the second week was also determined. Given the preponderance of economists at the meeting, and the failure to get very far in the discussion at the very first session of the meeting, it is unsurprising that four of the five were on economic policy. These were Contra-Cyclical Measures, Full Employment and Monetary Reform; Wage Policy and Trade Unions; Taxation, Poverty and Income Distribution; Agricultural Policy; and The Present Political Crisis. The last topic was suggested by Karl Popper, and referred to ongoing concerns with how to deal with Russia. The discussions in the

[27] Both the original and the final statement of aims are included in Hartwell 1995, pp. 41-42, 49-50. Allais disagreed with the group's stance on private property, this on vaguely Georgist lines. See Burgin 107, 257-58, n. 85.

sessions of the second week are fascinating to follow, both for their substance and for the way that they reflected tensions that would repeatedly recur in later meetings of the Society.

The first session was straight economics, specifically macroeconomics, and the direction of the discussion would be very familiar to economists of today. All agreed that the policy that was being everywhere touted – that governments had a responsibility for producing full employment, and should use Keynesian demand management policies to do so – was a dangerous one, especially to the extent that Lord Beveridge's definition of "full employment" (around 3% unemployment) was taken as appropriate. That way lay inflation, as well as a temptation for further government overreach when its unrealistic goal went unrealized, through directing labor, interfering with wage bargains, fixing prices, and so on. Given their rejection of Beveridge's approach, the next question was what changes might be made in monetary and financial institutions to reduce uncertainty and minimize the likelihood of a business cycle. A movement to a commodity reserve standard to provide the anchor that gold once provided, and the imposition of a 100% reserve requirement on banks to make the banking sector less volatile, were among these. A second set of issues was whether a rejection of Beveridge's Full Employment policy also implied a rejection of Keynesian demand management policy in a downturn. Robbins (who had turned from a critic to a supporter of Keynesian policy prescriptions during the war) insisted that Keynes and Beveridge were not the same thing, that in addition to pushing for greater wage flexibility the government might time its capital expenditures so as to mitigate the cycle – he did not use the phrase " with shovel-ready" projects but could have. This brought the predictable reply from Milton Friedman that it was difficult to get the timing of such expenditures right, and getting them wrong could exacerbate the cycle. Friedman argued that a system of monetary rules combined with a rearrangement of the tax system so as to make responses automatic rather than relying on discretion best reflected the liberal creed. Such debates are familiar territory to economists. The only outlier in the discussion was Röpke, who continued to tout his own unique hybrid of Austrian and Keynesian policy. When a boom is underway, the government should try to restrain it to keep it from overheating the economy. When the inevitable recession occurs, it should be allowed to run its course, unless a secondary deflation emerges, at which point Keynesian demand stimulus should be instituted. There was another way in which Röpke was different from the rest: he wanted to inquire what social philosophy a concept like Beveridge's Full Employment implied. No one responded to that; this was a discussion about economics, and only economics, an implicit limit that surely grated on Röpke's nerves!

Similar sorts of tensions were on display in the session on wage policy, and even more so the one on agricultural policy. In both cases, cultural differences as well as differences in institutional constraints that were seen as blocking possibilities for reform held center stage. Fritz Machlup did a masterful job introducing the main questions to be addressed regarding wage policy. He noted the contradiction produced when the presence of strong unions is combined with calls for Full Employment. His proposed liberal policy was to avoid cyclical unemployment via a proper monetary policy, to avoid regional pockets of high unemployment by encouraging labor mobility, and to reduce restrictive entry practices (e.g., closed shop laws) by unions. Other ways to reduce union power – by limiting the size or geographical scope of a union – might also be considered. This immediately brought protests that such steps though useful in theory could not possibly work in the speaker's country. There is no labor mobility in Switzerland, said Rappard. Other Europeans were split between simply encouraging dialogue between workers and management – Rappard and Lovinfosse favored this route; Knight, supposedly the great advocate of discussion, thought it unrealistic – and having some neutral party, usually the government, in charge of setting wages.[28] John Jewkes made the interesting point that it was the unions in England that were offering the most effective resistance to the Labour government's attempts to direct labor. No consensus was reached.

There was even more resistance to a "one size fits all" agricultural policy. On one side were those who felt that agriculture was truly different from other ways of making a living, and certainly from industry. For Röpke, of course, it represented a way of life, and indeed an end in itself, one that would provide a bulwark against "the proletarian nomads of industrialization." He favored a set of policies that would support the spread of the family farm. Others had less romantic views of the agricultural life, but still insisted that the sector was afflicted with special problems that demanded intervention. It seemed both unfair and inefficient that a bad growing season or two could put even good farmers out of business. Brandt, the agricultural specialist, felt that changes in credit policy – higher interest charges in good times, lower ones in bad – could help avoid such problems.

The opposition here included Loren Miller, who put the riposte precisely:

> Why shouldn't everyone be insured against the vicissitudes of the market, if farmers can be insured? What would be the sum of *all* the interventions which have been suggested during the conference. Wouldn't that be a planned economy?

Hayek supported Miller, noting that if one considers problems only one at a time, it is hard to keep one's mind on the general principles of liberal policy that they were seeking. And indeed it

[28] Lovinfosse, it must be noted, was probably the only person present who might have been involved in management-labor negotiations, and if we believe Brandt's casual observation noted earlier, he was quite successful at maintaining good relations with his workers.

was at this session that his plea that the conferees ignore existing political constraints was itself most ignored. Robbins, doubtless reflecting knowledge he had gained in his years of wartime government work, added that sometimes the best that a liberal economist could do, when faced with an illiberal government, is to advise on the least harmful way to achieve the illiberal aim. A Hippocratic oath of sorts for liberals in government, it actually captures rather well the general self-image of economists, if one substitutes in "efficiency" as the desideratum.

The final session on economic policy, on Taxation, Poverty and Income Distribution, was very much the Milton Friedman show. In his opening talk he reiterated that a rules-oriented monetary policy had the best chance of securing macroeconomic stability, and that the remaining problem of poverty could be handled by imposing a progressive income tax with a negative income tax (though he did not call it that) feature that kicked in below a certain level of income. This simple change in the tax system was all that was needed; all the other programs that were designed to combat poverty could, and should, be eliminated.[29] Dorothy Hahn's notes recorded a barrage of questions that followed. How would it work? At what income level would people start paying taxes, and who would decide that? What about farmers who didn't keep records of income? Won't those who work and pay taxes resent their money being used to support those who did not? In a classic Friedmanian performance, he answered each objection with a short, crisp reply. Hahn's hand would have been sore by the end of this session.

Hayek raised an interesting objection to Friedman's proposal: "Freedom not to work is a luxury which the poor country cannot afford." His solution was to provide a labor service, under semi-military conditions that paid below the prevailing wage, for those who would otherwise be

[29] The similarity to Director's proposals on these topics in his comments in the first session should be noted, though Director also discussed corporations and antitrust there. Both reflect Simons' influence.

unemployed. We note this because when Hayek sometimes during this period said that he favored a “minimum wage,” this is what he was thinking of: not a floor below which the wage could not fall, but a wage that was below the prevailing wage, and hence one that would not have much effect on the wage structure. In any event, no one took him up on it. Incidentally, this probably was the session in which Mises purportedly “stood up, announced to the assembly ‘You’re all a bunch of socialists,’ and stomped out of the room” (Friedman and Friedman 1998, 161), though clearly, given the general reception of his views, it might have been others as well.[30]

These four sessions bring out the fault lines apparent in later meetings: between economists and the more philosophically minded, between those looking for general principles and those focused on culturally-sensitive, country-specific solutions to particular policy problems, between the Americans and the Europeans, between the academics and the foundation representatives. The final session had fewer disagreements, but also fewer answers. What was the appropriate liberal response to the Soviet Union’s intransigent post-war stance? Liberals believe in the rule of law, in trade, peace, and tolerance. What to do when facing an uncooperative illiberal regime? With Nazi Germany the answer had been appeasement, with horrible results. Was the west in danger of making the same mistake again? Some – Frank Knight in particular – insisted on the importance of dialogue. But in spring 1947 not many others were prepared to follow him. Popper averred that he was “quite sure that Russia understands only the language of threats” and Lionel Robbins intoned that “You only get further with the Russians if you treat them as though they are *not* human beings.” Michael Polanyi concluded the

[30] Friedman appears to be the source of the widely repeated anecdote. There is nothing about it in Dorothy Hahn’s notes.

session with the comment that "Professor Robbins has said what I was going to say, but he's said it very much better."

On the final day a "Memorandum of Association" was adopted and the Society formed. Hayek was made president, and five vice-presidents were chosen: in addition to Eucken, these were Jewkes, Knight, Rappard, and Jacques Rueff. Director would serve as secretary, and C. O. Hardy as treasurer. In November 1946 the Society was incorporated in Chicago. This was preferable to London because, as Hayek pointed out, the presence of currency controls in England would have made transacting the business of the Society difficult (money could come, but not go out).

So Hayek had pulled it off, the first meeting anyway. He had shown considerable skill as both a fundraiser and a scholar who could attract similarly talented scholars to join him. But he also demonstrated a knack for keeping people with disparate views in conversation with one another. He expressed his own views, to be sure, but just as often he would try to clarify the debate and, by a keen ability to float above the fray, to keep the conversation flowing. Pictures at the meeting often show him beaming, enjoying the intellectual repartee, engaging his guests as a host at a dinner party might. The German economist Leonhard Miksch wrote in his diary about the 1949 Seelisberg meeting of the Society, noting there that Hayek "remains very discreet and smiles his friendly Viennese smile, both diplomatic and ambiguous" (quoted in Kolev, Goldschmidt and Hess, 2019, appendix). A very apt summary, that.

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The Road Not Taken of "Nuovo liberalismo"

Draft – do not quote without permission.

In 2009, the German Parliament approved a balanced budget amendment of the German Basic Law (article 109). The amendment prohibited any degree of structural deficit for local government (Länder) and allowed a very limited deficit (0.35% of the GDP) for the federal state. A balanced budget was aimed for 2016. Since 2012, Germany has run budget surpluses.

In 2012, the Italian Parliament approved a reform of Article 81 of the Constitution, aiming to enshrine into the Constitution a structural balanced budget rule. Italy run a fiscal deficit ever since.

There are certainly reasons other than political culture which explain the different fiscal behaviour of Italy and Germany in this period. In particular, Germany enjoyed " an unexpectedly dynamic recovery since 2010" (Rietzler and Truger 2019: 12) whereas Italy only returned to a positive growth rate in 2015 and hashad sluggish growth ever since.

Yet political culture certainly played a role, also in defining other countries' and investors' expectations. Today Germany is the country most closely associated with "austerity" (Blyth 2013), to the point that "Ordoliberalism" is seen as sort of a code word for German imperialism.

Left-of-center commentators and economists seem to believe that "the problem" (as they see it) lies in the fact that in Germany "Keynesianism never really took hold" (De Long 2015). While the idea that "German economists feed at the trough of 'Ordoliberalism'" was previously exposed as a myth (Burda 2015), it is clear that some Ordoliberal ideas did stick with the German political imagination. The German CDU, the Christian Democratic Party, regularly pays lip-service to Ordoliberal ideas (see Gauck 2014): now, lip-service is a big thing in politics, it means politicians believe there is something to gain by associating themselves with some thinkers and ideas. Furthermore, consider the constant polemics between the Bundesbank and the European Central Bank, with the first emphasising the limits of the latter's mandate, and in particular the need to focusi on keeping inflation under control. This *leitmotif* of the European political discourse would escape our understanding, if there was no ground to Jacques Delors's famous observation that "not all Germans believe in God, but all believe in the Bundesbank."

In recent years, the turn towards fiscal probity in Germany originated in the government's previous reliance on borrowing to take up almost the whole fiscal brunt of the country's unification in the early '90s. Germany has had very few classical liberal, "supply side" reforms in the last eighteen years, after the liberalisation of the labour market with the Hartz reforms. Yet there seems to be a widespread allegiance to the ideas of sound money and fiscal responsibility.

It is easy to forget that in the 1990s Italy experienced a short phase of fiscal probity too. In 1994, after a whole ruling class had been wiped away by the "Mani pulite" (Clean hands) investigations in

Milan, the country was weak and perceived as an economic basket case. Public debt reached 121% of GDP (it had reached 100% of GDP as recently as 1990). Entering the European common currency was seen as a necessity to re-establish the country's reputation. With such a goal, Italy did its homework. In the course of six years the government enacted fourteen "budgetary corrections" and two substantial reforms of the social security system (1992 and 1995). The country also enacted a wide program of privatisations, ranging from the state telephone company to highways to banks and insurance companies.

But Italy's 1990s fiscal probity proved to be a fleeting endeavour and was happily abandoned by the whole of Italian political parties. Its "fiscal populism," a bipartisan rejection of fiscal rules, has deep roots (Boggero 2020).

In *The Birth of Biopolitics*, Michel Foucault observes that for a government to *stay* relatively limited and frugal, it ought to be established on some classical liberal foundational myths: in the U.S., for example, "the demand for liberalism founds the state rather than the state limiting itself through liberalism" (Foucalt 2008: 217). Something similar may have happened to post-WWII Germany, where de-nazification required a profound change in the pantheon of political symbols.

We are on safe ground if we observe that, in Germany, the influence of the Ordoliberals contributed to "institutionalize" some key ideas, like the independence of the central bank or competition policy (on the influence of Franz Bohm, see Kolev 2019). Neither the Bundesbank's independence nor the Bundeskartellamt (the anti-trust authority) were mentioned in the German constitution, but they came to enjoy such a reputation that it made them semi-constitutional bodies.[1]The famous Godesberg Program, adopted by the Social Democratic Party in a "reformist" drift in 1959, can be seen as an attempt to come to grips with such institutions.

Italy lacked a similar development. Italian "neoliberalism" therefore was pretty much a road not taken: this, in spite of the fact that, in the immediate aftermath of WWII, it was actually a reality as concrete as the German one.

1. Luigi Einaudi and the Italian Reconstruction

"Postwar Italy was initially made by economic liberals such as Luigi Einaudi … Einaudi's emphasis on the importance of rules in framing economic life had a clear similarity with the thoughts of the German Ordoliberals" (Brunnermeier, James and Landau 2017: 238). Indeed Luigi Einaudi (1874-1961) himself spoke of a "'nuovo' liberalismo," though he quickly specified that "in principle, there is no substantive difference between the two strands of liberalism. Liberalism is one, and endures in time, but each generation needs to face its own issues, different from yesterday's and renewed by tomorrow's problems" (Einaudi 1945). Thus neoliberalism is simply an attempt to adapt the great principles of 19th century liberalism to the issues and challenges of the contemporary era.

I think we can safely say that, during his lifetime, Luigi Einaudi was second to no other liberal of his generation when it comes to personal prestige.. "Very few individuals anywhere in the world

[1] The Bundesbank's independence was consolidated in a series of conflicts with the executive and political parties over economic policies. See Bernhard (2002: 60-64).

have accomplished so much in a single life," to echo Alberto Alesina. Einaudi was "economist, historian, moralist, editor of several academic journals, public intellectual and regular contributor the Italian newspapers, correspondent of *The Economist*, Senator, central bank Governor, and the President of the Republic" (Alesina 2009: 16). Plus university professor and minister.

His career as a journalist, in a time when newspapers forged public opinion, made him a household name. But perhaps his achievements have something to do also with Einaudi's moral qualities, his reputation for probity and sobriety,[2] which made him a recognisable "personaggio" in the Italian political theatre.

Einaudi was invited to the first meeting of our Society in 1947 – but he was busy elsewhere. After the fall of fascism, he was appointed President of the Italian Central Bank in 1945 and in June 1947 he became Budget Minister and Deputy President of the Council of Ministers. The first meeting of the Mont Pelerin Society was instead attended by another Italian, philosopher Carlo Antoni (1896-1959), who was a follower of Benedetto Croce (1866-1952) and a prominent man of letters.[3]

The Mont Pelerin Society traditionally had only a handful of Italian members. This was true from the beginning, and surely it is consistent with the unpopularity of classical liberalism in Italian academia to this day. Yet in the very years our Society took its first steps Italian liberals had a unique opportunity to make a sort of "benign neglect" the de facto economic policy of the Italian government. As it turned out, they only succeeded in part and miserably failed inr many respects.

The Italian post-war reconstruction can be seen as akin to the German one. Similarly, policies of liberalization that allowed for rapid industrial development were followed in both countries. Similarly, they can be traced back to a group of intellectuals that, since they have not been tainted by any allegiance to the fascist regime, enjoyed a certain prestige and could "transfer" it to their liberal ideas.

However, there were also substantial differences, two being the most notable.

First, different than in the German case, Italian liberals never came to be perceived as a "school." They were for the most part economists that had been educated in the pre-fascist era, when Italian economics was "second to none" (Schumpeter 1954, 855)[4] and achieved international prominence thanks to Pantaleoni (1857-1924) and Pareto (1848-1923). Younger economists, educated to believe and preach fascist corporatism, respected them but clearly saw economic life differently.

Second, whatever the benefits of benign neglect in the short term, they were never quite "institutionalized." The Bank of Italy, though enjoying a wide prestige, was never the counterpart of

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[2] The most famous anecdote dates to Einaudi's tenure as President of the Republic. Journalist Ennio Flaiano was invited to the Quirinale, the Head of State's residence, for a dinner together with other intellectuals. When fruit was served at the end of the dinner, Einaudi said: "I'd like to have some, but these [pears] are too large. Does anybody wish to share half with me?" Referring to widespread corruption in the Italian Republic, Flaiano noted that after Einaudi the era of "undivided pears" begun (Flaiano 1970).

[3] It is likely that Antoni was an acquaintance of Wilhelm Röpke and recruited as such (Cubeddu 2002: 163fn).

[4] Einaudi and the group of scholars headquartered around him in Turin were the main catalyst of such developments in scholarship (Marchionatti, Cassata, Becchio and Mornati 2010).

the Bundesbank in its economic preaching. A constitutional proviso on competition policy and monopoly was discarded and the country chose not to have a competition agency until 1990.[5] The constitutional article which was meant to require a balanced budget was substantially ignored ever since the 1950s.

2. The Free Market element in the Italian reconstruction

According to a major critic of Italian free marketeers, Italy enjoyed a de facto classical liberal economic policy "from February 1944 up to 1952" (Saraceno 1977: 143). This could be explained by "several factors" A substantial one was that "a number of much esteemed and extremely learned economists participated from a privileged perch to the government operations and the public debate in those years. [Yet] a greater weight should be placed on … the widespread inclination to identify anti-fascism with free-market economic ideas… and, of course, the political influence of the interests advantaged by free-market polices" (Saraceno 1977: 125).

The last point – the eternal burden of economic liberals, namely the prejudiced view that *laissez-faire* would be a boon to industrialists – reflects Pasquale Saraceno (1903-1991)'s own views (he was, in today's jargon, a champion of "state capacity"). More worth considering, in our context, are two other points he made: the identification of anti-fascism with economic liberalism, and the prestige of economic liberals..

Among the latter, Einaudi was clearly the leader. But there were other notable figures too, both on the strictly political and on the scholarly side.

Liberal politician Marcello Soleri (1882-1945) was briefly Minister of Labour. He enjoyed substantial prestige because he never acquiesced to fascism.

Epicarmo Corbino (1890-1984), a self-described "Marshallian" economist (Cavaliere 2012) and a stubborn advocate of free enterprise, was Minister of Industry in 1945 and Treasury Minister in 1946, successfully opposing the Communists' plan to levy a real estate tax.

Giovanni Demaria (1899-1998), deputy rector of Bocconi University in 1945 and later a Mont Pelerin member, had an intense journalistic activity at the time and chaired a committee that produced some preliminary work on economic matter for the Ministry for the Constitutional Assembly – and, thus, the work of the Constitutional Assembly itself (the Ministry was created to pave the way to the Assembly).

Costantino Bresciani-Turroni (1882-1963), whose highly renowned *The Economics of Inflation* was published in 1931 and translated into English in 1937, was a member of the Constitutional Assembly and wrote in 1945 the economic manifesto of the Liberal Party. Publishing the second edition of his *Introduction to Political Economy* in 1945, Bresciani-Turroni attempted to lay down some principles for post-WWII Italy.

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[5] Classical liberals are rightly skeptical of antitrust (see, *inter alia*, Armentano 1990) but, in the Italian case, the decision *not* to have an antitrust authority was motivated by the political will to preserve government monopolies as they were – not by an understanding of the dynamics of competition inspired by the Austrian school of economics.

Ernesto Rossi (1897-1967), who later became more famous as a journalist, was a high school teacher who had been jailed by fascists in 1930. In jail, he studied economics (that Einaudi took him under his wing enabled him to receive books) and translated an abridged version of *Collectivist Economic Planning* (without Enrico Barone's essay), which was published by Einaudi's son publishing house. After the war, Rossi was appointed President of ARAR (Azienda Rilievo Alienazione Residuati): this was an agency established to privatize the "left-overs" of the British, American and German armies on the Italian territory. Rossi deployed ARAR to the service of free-market policies. He needed to deal with the U.S. government, which was claiming 160 million dollars (at 1945 values) as the price of the military equipment left in Italy on the one hand, and with several Italian industrialists on the other, who strove to grab valuable resources, from rubber and metals (steel, nickel, copper, tin) to vehicles (some 300,000, at a time when the motor-vehicle fleet circulating in Italy was in the low 10,000s). This material proved to be an essential resource for the Italian post-war reconstruction. As Chairman of ARAR, Rossi established the principle of public bids for the sale of small batches of materials, to counter the demands of great organised groups, corporatist influences and the assaults of trade unions.

Thus, we can indeed see hat, like Germany, Italy had quite a few prestigious figures, who steered it in a more, albeit precarious, classical liberal direction.

Such a turn was helped by the fact that it was recognised (at least then!) as antithetical to the way in which fascism attempted to "manage" the economy.

It is true, as our intellectual opponents never cease to remind us, that when Benito Mussolini took office he expressed some moderate support of a free market economy, and balanced the budget in 1923. Yet he soon took another path, becoming a champion of a "corporatist" economist reminiscent of Medieval guilds. The bulk of Italian banks were nationalised when IRI, the Istituto per la ricostruzione industriale [*Institute for Industrial Reconstruction*], was established in 1933. On May 26, 1934 Mussolini could declare to Chamber of Deputies that "Three-fourths of the Italian economy, industrial and agricultural, is in the hands of the State." By 1939 the IRI and other government agencies "controlled over four-fifths of Italy's shipping and shipbuilding, three-quarters of its pig iron production and almost half that of steel." According to Martin Blinkhorn (1994: 35) "this level of state intervention greatly surpassed that in Nazi Germany, giving Italy a public sector second only to that of Stalin's Russia."

Price controls were established first in 1935 and tightened in 1940, when Italy entered the war. Italy's participation in WW2 was "an economic disaster. Whereas between 1915 and 1918 GDP had grown on average by 1.9 percent per annum, it decreased on average by almost 10 percent every year between 1940 and 1945" (Toniolo 2013: 20). In 1945, Italy's GDP per capita stood at the level of 1906.

The reconstruction was fast: by 1949 Italian GDP was already 10 percent higher than in 1939, the best pre-war year. 1945 had seen the worst depression in consumption[6] but by 1950 consumption reached back its pre-war highest levels[7] (Saraceno 1977: 7). In 1953, "Italy's pro-capita income,

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[6] Consumptions decreased to 40% of pre-WWII levels.

[7] In the meanwhile population increased by 2 million people: Italian population was 43,4 million in 1938; 45,3 million in 1945; 47,7 million in 1953.

with a population increase of some 3-4 million as compared to the pre-war years, was 31% higher than the highest pro-capita income reached before the war" (Saraceno 1977: 16)

Furthermore, the integration with the international economy was a success: "the share of exports of goods and services as a percentage of the national product grew to 21% in 1965 from 8% in 1938" (Baffi 1966: 12).

Can these successes be considered the outcome of free-market policies?

In 1947, price controls, beginning with the administered price of bread, were basically abolished. The country had a period of runaway inflation, instrumental in wiping off most of the government debt. Yet, summer 1947 onwards, the Bank of Italy took an "orthodox" (as the critics would call it) macroeconomic policy stance (the lira was a remarkably "sound" currency for the 1950s), was admitted to the Bretton Woods institutions and chose firmly to integrate into the international economy.

It is widely recognised that, if "since the time of the crisis of 1929 an autarkic drive had impacted [Italy's] production development, … after the war, in contrast with the previous autarkic policies, a policy was adopted of deeply engaging our country with the international economy" (Saraceno 1977: 4).

Can we trace these policies back to the action of classical liberals?

Einaudi was surely personally responsible for the masterful management (between discretion and injunction) of the central bank. He and Corbino could be credited for pushing the idea of a profound Italian integration in the European economy. Such an idea found a friendly hearing from Prime Minister Alcide De Gasperi (1881-1954) who, though being relatively unschooled in economics,[8] had a strong sense of the new Republic belonging to Europe and the Western world.

Furthermore, we can say that liberals perceived the reconstruction as an opportunity to foster a different understanding of the relationship between state and market.

Costantino Bresciani-Turroni published the second edition of his *Introduzione alla politica economica* published in 1944. In the book he argued explicitly that price controls, even relatively successful ones as the ones he saw implemented in Germany, won't survive peace. "The issue of government-imposed price controls should be reviewed in the light of the requirements of a peacetime economy. The challenges, the flaws, the inherent systemic unbalance – accepted today as the consequences of measures justified by the anomalous circumstances created by a war – will appear increasingly serious as the need of those measures will disappear and new needs will made themselves manifest, namely, the need of repair, by means of a swift increase of production, of the material destruction occasioned by the war" (1944: 166)

That work by Bresciani-Turroni aimed, in a certain measure, to rebuke the idea, popular at the time as it is today, that "the semi-liberal economy of the past is definitely waned and that, even after this war is over, a system of regulated economy will persist" (371). A regulated (corporatist) economy

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[8] Yet De Gasperi had a good grasp of fundamental questions, being for example personally committed to the idea that only a balanced budget could help to restore confidence in the Italian lira (Gioli 1980: 69).

for him was not “a new economic system, a synthesis of sorts between individualism and socialism. it is but a series of encroachments that – albeit on perfectly justified political, social, and moral grounds – hinder the achievement of the maximum production” (372). Its key feature was the rejection of “economic laws” (373), by which he meant the principles of classical political economy that “foist … limits on the government’s scope” (379).

Breciani-Turroni (a gifted scholar though perhaps not the most gifted of economic popularizers) set to explain to the public why the command and control economy should not survive the war.

Indeed, for a little while at least this notion seemed to have traction, in Italy. The circumstances were helpful: the dramatic collapse of the fascist state, the time needed to re-engineer the bureaucracy, the sheer lack of concrete proposal for planning and top-down regulation of the economy left a *vacuum* which the liberals filled. I do not want to suggest that they had an honeymoon with the other Italian political parties, as they needed to play the political game in full, including resigning as Corbino did in 1946 (from a government that included communists and socialists), but to the effect to save the policy of limited spending and moderate taxation which he pursued as Treasury Minister (Gioli 1980).

Leftist parties were strong but the strongest of them, the Communist Party, exhibited a certain degree of prudence in moving its agenda forward. Even at the first Economic Congress of the Italian Communist Party “there was no request for a planned economy” (Martinelli 1976: 36). The idea of a thorough socialisation of means of production were postponed until after electoral victory, were it to come in 1948. More “moderate” left-wing parties (the Socialists and, in particular, the Republicans, always the political arm of Italian Keynesianism) were more pressing in their demands but, overall, the policy the De Gasperi government followed was one of liberalization, control of inflation, limited spending.

3. The Italian Constitution

What did go wrong, then?

Buchanan (1919-2013) distinguished between two levels of public choice – the initial or first level sets the rules of the game through the choice of a constitution and the second or post-constitutional level involves playing the game within the rules.

The liberals, in the immediate aftermath of WWII, played a good game in the post-constitutional level, in crafting policy choices – but they lost the game at the constitutional level, where at that time the rules were being rewritten.

The Italian Constitution was not the brainchild of a team of jurists or of one or more “technical” committees: it was the outcome of a Constitutional Assembly, elected with a pure proportional representation system.

In such an Assembly, the Christian Democrat, the Socialist and the Communist Parties commanded 75% of the votes and, therefore, of the seats. The first Liberal list gained 6,79% of the votes.

A Ministry of the Constitutional Assembly was to prepare some preliminary work for the future Constitution, and had a specific economic committee, chaired by Demaria. Yet they had little time to work and, according to most commentators, limited influence.

The drafting of the Constitution was done by a "Commission of 75," an appointed group of the 556 elected members of the Assembly. Luigi Einaudi was a member of such a Commission, though he resigned when he became Treasury Minister. He was part of a group of three liberals, and the only economist. The Commission had quite a few academics within its ranks, but mostly jurists.

The Italian Constitution enjoys a distinctive peculiarity: it was written before it was clear (in 1948) whether the newborn Republic was to stay within the "Western" bloc, or to join the Eastern one. That choice was, understandably, left to voters. The Constitution had therefore to be versatile, possibly accommodating both options. As the leader of the Communist Party, Palmiro Togliatti, noted: "we are drafting a Constitution which is not socialist, but is instead a Constitution fit for a time of struggle for an economic regime of co-existence between different economic forces, which strive to overcome each other" (cited in Beretta 1988: 407).

The first article (the rather sibylline "Italy is a Republic founded upon labour") and, in general, the discipline of labour relations reflect the wide convergence between Catholic social thinking and full fledged socialism. Italy has a "constitutional right to strike" for workers and four articles of the Constitution that deal with matters pertaining the organization of trade unions. On the other hand, article 41, the core of the "economic Constitution," reads as follows:

> Private enterprise is free.
> Its operation may not be in contrast with social utility, nor it may harm safety, freedom, and human dignity.
> The law establishes the suitable programs and controls such as public and private economic enterprise may be directed to social purposes.
> [*L'iniziativa economica privata è libera.*
> *Non può svolgersi in contrasto con l'utilità sociale o in modo da recare danno alla sicurezza, alla libertà, alla dignità umana.*
> *La legge determina i programmi e i controlli opportuni perché l'attività economica pubblica e privata possa essere indirizzata e coordinata a fini sociali*].[9]

It is safe to say that the Constitutional convention was driven by a highly skeptical view of free markets. There, as noted by Pasquale Saraceno (1977, 24), "Marxist thought and Catholic social thought met on the issue of controlling the capitalist anarchy." The result was a Constitution that values private enterprise only for its 'social utility 'and does not consider private property a necessary bulwark of liberty (on this, the most relevant influence was the Catholic social thinking,

[9] Bizzarrely enough, this formulation, mentioning "programs," was justified by socialist politician Giuseppe Arata (1901-1990) mentioning Hayek's Introduction to *Collectivist Economic Planning*, where he advanced "the distinction between a permanent legal framework so devised as to provide all the necessary incentives to private initiative to bring about the adaptations required by any change, and a system where such adaptations are brought about by central direction" (Hayek 1935: 22). If "programs" were mentioned, economic planning was not, because of opposition by Corbino and Einaudi but also by others, including socialist Antonio Labriola (1873-1959) who commented that "at least in Italy, a comprehensive planning would mean the subjection of industry … to officials" (Barucci 1980: 51fn).

see Barucci 1980: 39-41). Insofar as they scored some points, the liberals did so in limiting damage, so to say. It is worth noting that such successes came in plenary meetings of the Assembly, and not in the committee of 75 where the actual drafting was done (Barucci 1980: 53-54).

It is worth mentioning two of the battles that Luigi Einaudi fought, and lost, in the Constitutional Assembly.

There was a wide discussion over monopolies and competition. The liberals tried to amend the above-mentioned Article 41, adding a section that could somehow constitutionalise the idea of free competition as a public good. After a first proposal from Guido Cortese (1908-1964), who wished to mention the idea of consumer sovereignty ("The law regulates by statute all economic endeavours with the aim of safeguarding the interests and the freedom of consumers"), Luigi Einaudi proposed his own solution: "Statutes may not be instrumental in establishing economic monopolies; where these do occur, they are subject by statute to public control by means of delegated or direct public administration."

In the Assembly, he said that monopoly was "the deepest evil of this society," a sort of theft of which government should not be an accomplice. He ridiculed the idea that nationalisation was the proper response to economic concentration: "It is tantamount of telling the constable facing the public highwayman who robs the traveller: you are not to seize the robber. Indeed, you are to change into a robber yourself, and you shall plunder those who travel the roads."

The background to this controversy, besides the relevance of government monopolies such as the railways, radio communications or over particular goods (beginning with tobacco and salt), is the existence of IRI, the Institute for Industrial Reconstruction, which we have already mentioned. The mere presence of such a vast government-owned conglomerate in the Italian economy was bound to influence the future of the country's economic life.

Only a few voices called for the privatization of state assets. One was Alberto Frassati (1868-1961), a newspaper man who became a gas and electricity entrepreneur, denouncing IRI to the Demaria committee as "the greatest immorality conceivable … it amounts to an unbalancing element among all industries."

"If, for instance, I am the owner of a humble pipe-producing factory – so Frassati explained – how can I survive when IRI enjoys every benefit and produces pipes as I do? Whatever liability it may accrue, IRI can easily disregard, as the State will cover it. It is impossible for a business to prosper whenever there is an actor which is not a business, but the State itself."

This was exactly the kind of reasoning which inspired Einaudi's attempt to enact an amendment to article 41 of the Italian Constitution. No private competitor could thrive, in the presence of such an incumbent. Yet IRI was untouched, and it was destined to remain active, and continue to grow, until the late 1980s. The reason why it was untouched was that there was no Italian capitalist who could acquire "heavy industries," like steelmaking companies, and manage them properly. Private capitalists lacked resources and expertise: which is exactly the reason why they were criticised seventy years later, when IRI businesses were privatised. In a sense, the choice *not* to privatise IRI was key in keeping private capitalists "in captivity" – the best they could hope was to be a supplier of an IRI company!

This does not mean that IRI companies were necessarily badly managed, particularly at first. In a sense, private ownership was the conduit for the establishment in Italy of a particular blend of *managerial capitalism*. Most of the country's private businesses were small, mom-and-pop or formerly mom-and-pop establishment. IRI companies, on the other hand, were managed by an elites of civil servants turned CEOs.

The most egregious case is another state business – though not controlled by IRI – namely ENI, Italy's oil company. It came out of the entrepreneurial genius of Enrico Mattei (1906-1962), an undoubtedly spectacularly talented entrepreneur who, lacking his own capital and lacking possible Italian backers (as virtually none was in a position to sustain such a great endeavour), called on the state to be his shareholder. Mattei was severely criticised by Fr Luigi Sturzo (1871-1959), the Catholic priest who founded the Popular Party before WWI and that after WWII came to be, with Einaudi, the most vocal partisan of free enterprise. Sturzo understood well that, to gain latitude as a businessman, people like Mattei needed to pamper political leaders and saw that government ownership was to be a constant source of corruption. The "Clean Hands" investigations in the early 1990s proved him right, almost half a century later.

The other major battle in which Einaudi engaged dealt with the possibility of adding a debt brake to the government's budget. Einaudi originally wanted to restrict the spending enacted by Parliament since an expanded role of the legislature, meaning its capacity to amend budget decision, appeared as a potential source of deficit finance. Einaudi feared the degeneration of parliamentary debates, in which political majorities were to loosen the public purse strings in order to meet the interests of their constituents. So, originally Article 81 of the constitution was to forbid the Parliament from amending the state budget submitted by the cabinet for approval (Giannitti 2011), while Parliament would of course have retained the ability of approving or rejecting the budget in its entirety and certainly to held the government accountable.

Such a proposal was considered too "extreme" (isn't [neo]liberalism always considered too extreme by its opponents?) and the the final text of the Article read, in the last two commas, "The statute that approves the state budget may not establish any new taxes, nor any new spending items. Any other statute which enacts new or greater spending items shall provide for the means to cover them [*Con la legge di approvazione del bilancio non si possono stabilire nuovi tributi e nuove spese. Ogni altra legge che importi nuove o maggiori spese deve indicare i mezzi per farvi fronte*]."

According to Einaudi, but also to the Catholic economist Ezio Vanoni (1903-1956), this Article was meant to *imply* the need for a balanced budget. Such an interpretation lasted only for the 1950s and later on political parties started to happily engage in deficit finance: they passed laws requiring new expenses, without explicitly provide for a source of income to cover them.

We can thus say that the Italian economic boom, predicated on a sort of benign neglect, happened in spite and not because of the new republic's legal framework that was coming into being.

4. Why Italian liberalism didn't last

We tend sometimes to endorse a rather simplistic model of social change. "Ideas have consequences" is the title of an essay by Richard M. Weaver (1910-1963) but also the selling proposition of any think tank executive. Ideas walk on the legs of men

To quote John Stuart Mill:

> Ideas, unless outward circumstances conspire with them, have in general no very rapid or immediate efficacy in human affairs; and the most favourable outward circumstances may pass by, or remain inoperative, for want of ideas suitable to the conjuncture. (Mill 1845: 370)

Circumstances conspired briefly with "neo-liberalism" in post-WWII Italy. It success was contingent upon the needs of economic recovery but did not last. This gap between short term success and long term defeat is a matter to consider, in a conference like ours that deals with "ideas and action for a free society." Policy successes can endure or not, depending on the wider constitutional framework.

Why did Italian "neo-liberalism" not endure, as opposed to its German counterpart?

This is a complex question, to which I will try to provide simple, and thus partial, answers.

The rather obvious fact is that, though Italy secularised fast, more Italians do believe in God than they do in the Bundesbank! Indeed, did they have a Bundesbank to trust in?

I do not want to be ungenerous to the Bank of Italy, an institution of great reputation that gave sound advice to the Italian government over time. Between the 1960s and the 1980s, monetary and fiscal policy were in a forced wedlock, in which the central Bank de facto lost its autonomy: the Bank of Italy concurred substantially with financing of the deficits, and its share of total debt more than trebled between 1961 and 1970.

Though the Bank subsequently regained autonomy, it never quite subscribed to an economic philosophy of her own. This reflected, of course, the state of the economic debate in the country. Culturally speaking, though Einaudi was the most prestigious of its Governors, it is surprising how little the Bank was influenced by its economics.

This lack of a tradition brings us back to a question that pertains to the world of ideas: why Italian liberals did deplete in numbers, in spite of their policy successes?

To assess how ideas percolate in society is always a a matter of hypotheses. Let me advance some.

A most obvious one is that Einaudi enjoyed a wide prestige in post-WWII Italy, but he was an old man. His free-market comrades were old men too and they substantially failed in catching the imagination of a new generation, which was already mesmerised by different ideological approaches that shared a disdain for whatever the "spontaneous order" of the market economy produced. Keynesianism took off relatively late in Italy, but it was preceded by strong waves of Marxist economics, in its Sraffian incarnation. Indeed the Cambridge-tenured Piero Sraffa (1898-1983) "became a national symbol that radical political economists liked to invoke" (Brunnermeier, James and Landau 2017: 238). In the early 1970s, the then Governor of the Bank of Italy Guido

Carli (1914-1993) was flirting with the idea of establishing a PhD school under the auspices of the bank. As a director of the school, he was thinking of Piero Sraffa!

This was indeed the time when it was needed to "make the building of a free society once more an intellectual adventure, a deed of courage" (Hayek 1949: 423), to attract younger, brilliant minds. In Italy it did not happen and the Einaudi's generation had no immediate heirs.[10]

Lacking any strong "institutional" presence (a publishing house, a think tank, an University department committed to act as a hub for liberal ideas), classical liberal ideas succumbed in the arena of intellectual debate.

This arena was not empty, and anti-liberal *Weltanschauungen* came to dominate it. The generations of Italian who grew under fascism clearly thought these worldviews to be more attractive than liberalism.

For one thing, "the corporatist practices of the interwar period remained quite powerful in postwar Italy, and many economists argued that there was a good way of thinking about how state action could overcome collective action problems" (Brunnermeier, James and Landau 2017: 238). Such a concept was naturally receptive to partisans of a mixed economy, if not of altogether nationalization.

Sraffa enjoyed a wide influence in Italy – but such influence should be seen in the wider context of a general strategy inspired by his friend Antonio Gramsci (1891-1937). Gramsci "was unique among Communists in persisting, at the nadir of the defeats of the thirties, to see that Russian experience could not be merely repeated in the West" (Anderson 1976: 50). Gramsci thought that the specific character of a socialist revolution in the West required a" war of position" to alter the balance of forces, to organize and expand proletarian hegemony and to prepare for the revolutionary event.

After 1948, the Italian Communist Party found itself in a difficult situation: it commanded one third of the electorate but could not win general elections, not even by a policy of alliances, as the country in 1948 committed to NATO and the Western bloc. This shifted the *locus* of political fight and made Gramscianism – i.e., the quest for seizing the commanding heights of culture and society – the obvious and sound political strategy.

The commanding heights to be seized were in the trade unions, in the judiciary ,but first and foremost in the great cultural agencies (universities, publishing houses) in a sort of *entente cordiale* with the Christian Democrats: the latter were busy governing Italians, whereas the Communists could attempt to govern the minds of the Italians.

The quest for hegemony was by and large successful. In a way, this strategy implies an "all-embracing" vision of politics (which becomes a decisive factor not only in the social sciences, but in any kind of intellectual and even artistic endeavour, from biology to chamber music) which

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[10] It is telling that the most brilliant and articulate of Italy's free market economists, Sergio Ricossa (1927-2016), a member of our Society who also served as Vice President in the late 1970s, began his career as the "importer" of linear programming (LP) models into Italian academia.

naturally resonated with the, however rebellious, sons of the fascist regime ("Everything in the State, nothing outside the State, nothing against the State"). The space for any intellectual option which was not openly inimical to Western capitalism was therefore severely limited.

But this would not be enough as an explanation.

Another important factor was that, whereas in other countries free-market policies found a natural ally in conservative sensibilities, in Italy that was not possible because of the anti-Catholic nature of Italian liberalism.

In a sense, it was liberals, starting with the Count of Cavour (1810-1861) that *made* the Italian State, that governed the unification process in the 1860s. The greatest casualty, in the Italian unification process, was the temporal power of the Pope.

This created a never totally resolved tension between Catholics and Liberals. If a number of Catholic active in politics – most notably Sturzo and De Gasperi – could have a not entirely hostile sensibility to the ideas of classical liberalism, distinguishing them from the particular case of their Italian followers, most Catholics involved in politics saw the secularist liberals as an enemy. And vice versa. Anti-clericalism long remained a feature of the small Italian liberal party.

In some instances, it was perhaps the only long-lasting feature. In the 1880s, when the Italian government was moving away from free trade, Pareto (1888: 5) noted that the very government that was seriously injuring liberty was keeping liberals happy with "some measures against the priests."

The distrust between Italian liberals and Italian Catholics was mutual, though perhaps the best representatives of both camps (Sturzo, De Gasperi, Pareto, Einaudi) were immune to it.

In the post-war years, with the partial exception of a brief phase of the Jesuit journal *La civiltà cattolica* which seemed to support price liberalization, most Catholic intellectual ventures welcomed a possibile encounter with the socialist, and not the classical liberal, culture.

Bruno Leoni (1913-1967), a former Secretary and President of our Society, in his most famous book pointed out that economic planning needed legislation that was similarly inflexible and top-down. Such an understanding of legislation came naturally to Leoni, who, as an Italian, knew a country in which anti-clerical liberals typically identify with the state (instead of considering it at best a necessary evil), because of the way it formed and Catholics, though skeptical of the state precisely for the way it formed, embraced happily the idea of using legislation to solve whatever social evils. Liberals and conservative Catholics, who in other countries came to an agreement over a positive appreciation of bottom-up civil society processes vs top-down government decisions, in Italy never reached a common understanding.

In establishing the Mont Pelerin Society, Hayek wanted to name it after Acton and Tocqueville: two Catholics. He felt it was essential for the preservation of liberalism that its traditional antagonism towards Christianity be overcome (Caldwell 2020, 42). We know that, in following years, this was not always a theme at the center of the discussions in our Society, not least because the Society ended up being dominated by economists. If the Mont Pelerin Society had better pursued this goal, and if Italian members had been involved in some attempt to build bridges to the Catholic world, the Society may have had a bigger impact in the Italian cultural debate.

These "cultural" explanations do not substitute more "political" ones: the Italian Constitution was the result of a compromise, it was drafted by an elected body in which liberals were very few, and in subsequent elections the Liberal Party never commanded more than 7% of the votes.[11] I hope they complement them.

A lesson we may draw for our daily activity is that ideas that have consequences can never be examined, nor pursued, in isolation. Scholarly excellence is not enough to guarantee their victory, nor its intellectual prestige. To achieve success over time, they need somehow to be enshrined in the rules of the game. And for this to happen, they must gain ground against their opponents, and win some allies.

Italy had arguably three classical liberal phases in her own unitary history:

- right at the moment of the unification, when it enjoyed free trade and fiscal probity until 1876;
- in the aftermath of WWII, when the seeds of the transformation of the country from a country of peasants to an industrial powerhouse were planted;
- in the 1990s, when public finance was straightened, government industries privatised and Italy joined the euro (this latter produced by necessity more than any ideological commitment).

None of these phases produced a "hegemony" of liberal thinking, but they all had enduring consequences – and not bad ones. All three of these phases were marked by a strong belief in the integration of Italy in the world economy.

That liberal policies did not last *in spite* of their success is what demands explanation. I have advanced some hypotheses concerned with the world of ideas. Others can certainly be advanced that deal with the world of interests and with the very dynamics of the political process itself.

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[11] Curiously, that happened in 1963, when the Party campaigned against electricity nationalization. Later on, the Party put much water into its free-market wine.

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The Reception of *Free To Choose* and the Problem of the Tacit Presuppositions of Political Economy

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It is hard for today's students to appreciate the economic reality of the late 1970s, an economic reality of high unemployment, high inflation, and general economic malaise. This situation was true not only for the "rust belt" sections of the US economy, such as Pittsburgh's steel industry or Detroit's automobile industry, but coal and energy industries as well as industrial manufacturing in general were all in decline. This sense of economic malaise and political turmoil was not isolated to the United States. The United Kingdom was experiencing decades of economic decline, as well social disruption due to strikes and violence, and the world learned of economic, political and human rights crises throughout Latin America and Africa. India and China continued to languish in extreme poverty. The economies in East and Central Europe and the former Soviet Union were also stagnating and falling behind even the stalling economies of the mature western democracies of France and Germany. Economic malaise and political turmoil were a global phenomenon of the 1970s and early 1980s. Milton Friedman and Rose Friedman sought to explain the reasons for this sad economic reality with special reference to the public policy discussions in the US.

Milton and Rose were veterans in both the scientific contestation in the economics discipline and the general clash of ideas among the intelligentsia and the public policy community. *Capitalism and Freedom* (1962) was an international best seller, and Milton Friedman's columns in *Newsweek* as well as elsewhere, including numerous appearances on TV and radio made him

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by the late 1970s perhaps the most recognized economists in all of the US, and perhaps the world. His 1976 Nobel Prize, of course, also solidified his reputation in the public imagination. In fact, it is perhaps no exaggeration to say that other than John Maynard Keynes, no economists in the 20th century achieved simultaneously scientific and public acclaim as Milton Friedman. And, Friedman, who obviously possessed a sharp analytical mind was gifted with a quick wit, and a charming personality which made him such an engaging guest on TV from the Phil Donahue Show to Book Talk on C-SPAN. Others are not so gifted. This rare set of gifts I will return to at the end of my paper. The reason is that my central thesis concerns the concept of the "tacit presuppositions of political economy" that are held at any specific historical epoch. Thomas Sowell has brilliantly worked with the idea of "visions" -- in particular the constrained versus unconstrained vision -- but this is a slightly different idea. Joseph Schumpeter had also earlier contrasted "vision" with "analysis", and insisted that while in science and scholarship we judge contributions mainly by critical examination of analysis (logical and empirical) there is a vital place in science and scholarship for recognizing vision as the essential pre-analytic cognitive act that provides the questions for us to ask, and the raw material from which we commence our analysis. But even here, the concept of "tacit presuppositions" is slightly different. The concept comes from James M. Buchanan, and it relates to the unquestioned lived reality of the relevant population under investigation.[1] What they "take for granted" to be the reality of the situation. It is this "taken for granted" that determines how new ideas are heard, received, understood, and reacted to. Wresting control of that "taken for granted" and in the process shifting the "tacit presuppositions of political economy" was Milton and Rose Friedman's great gift, and *Free to Choose* is a perfect illustration.

[1] Buchanan first develops the idea in his work with Richard Wagner *Democracy in Deficit* (1977) and the idea of the Harvey Road presumptions that frame and give rise to the Keynesian revolution. But the idea of "tacit presuppositions of political economy" is more fully worked out in his work on post-communism, see Buchanan (1997).

J. S. Mill, in an essay on the 'Claims of Labour' in 1845, postulated that when ideas are introduced without the appropriate circumstances, they just fade into the background, and when circumstances arise but there is a lack of ideas to frame and guide the moment opportunities for change will be missed. *But* when the right ideas met up with the appropriate circumstances, social change can be rapid and decisive. The Friedmans make a similar claim about the "tide of opinion" and how that must precede the shift in policy. Policy ideas which are considered outside of the bounds of the reasonable in one era will be considered commonsensical in another era depending on the shift in the tide of opinion. "A tide of opinion," they write, "once it flows strongly, tends to sweep over all obstacles, all contrary views. Equally, when it has crested and a contrary tide sets in, that too tends to flow strongly." (Friedman and Friedman 1980, 272)

Textbook economic models often work best when unique individuals are minimized in their influence on outcomes. That makes analytic sense as the focus is on market theory and the price system. But as various theoretical conundrums that have been exposed in basic theory, this analytical move has a cost -- namely the loss of our ability to understand market makers and trend setters, in other words the entrepreneur as the prime mover in the competitive market process. In our understanding of the history of social change, I would argue, we make a similar mistake if we discount the power of specific individuals and focus instead on abstract ideas and momentary circumstances. In the clash of ideas just as in the contestation of the market, there are pivotal people at pivotal times. Milton Friedman was such a pivotal person, and he changed the world because of it. He was able to do that because his unique talents enabled him to wrest control of the "tacit presuppositions of political economy" of a historical era, and as Andrei Shleifer (2009) summarized as "The Age of Milton Friedman" which he dates from 1980-2005. An era, Shleifer adds, that was characterized by a sharp rise in global living standards, while by all statistical indicators life expectancy, educational attainment, and the establishment of democracy improved across the globe, and absolute poverty declined globally. That there is a dispute about this, I would argue, is one of the strongest pieces of evidence in favor of the power of the concept of "tacit presuppositions of political economy".

This essay will proceed as follows. Section II will discuss the reception of *Free to Choose* in real time circa 1980-82 prior to Friedman successfully shifting the tide of opinion. I focus on reviews by Robert Heilbroner and Kenneth Arrow in an effort to capture the tacit presuppositions of political economy that were in place in the post WWII period that Friedman had to buck up against throughout his scientific career and in his career as a public intellectual. Section III will discuss Friedman's wresting control of the tacit presuppositions and the global impact of that first with the reforms in China (Deng Xiao Ping), Britain (Margaret Thatcher), and Ronald Reagan (United States), followed with the collapse of communism in East and Central Europe and the former Soviet Union, and finally the reforms among the Nordic countries as well as India, East Asia, Latin America, and Africa. The ideas in *Free to Choose* concerning the power of the market and the tyranny of controls spread throughout the globe, and a new era of economic freedom and international commerce lifted mankind to new heights of improvement in living standards and provided the "great escape" from poverty. It is a fact that must always be acknowledged when debating the merits of this era of globalization that in 2015 for the first time in human history less than 10% of the world's population was living on less than $2 per day. This decline in extreme poverty in absolute terms must never been forgotten as we contemplate the human condition. But, it is also not the end of the story, as I will discuss in Section IV because our era faces different challenges, and those "tacit presuppositions in political economy" have once more shifted due to discontent with globalization, the consequences of the global financial crisis, and concerns with inequality and injustice. This challenge is a significant one for those of us influenced by the ideas in *Free to Choose* as educators, as scholars, and as citizens. After discussing these challenges, I will conclude the essay with a reminder of the main lessons from *Free to Choose* and a call to embrace the radical liberalism of Hayek, Friedman and Buchanan but adopting its core principles for our age.

II. Reception of *Free to Choose*

Both *Capitalism and Freedom* (1962) and *Free to Choose* (1980) were in the same intellectual tradition as Hayek's *The Road to Serfdom* (1944) and *The Constitution of Liberty* (1960). As such these were foundational texts of the intellectual motive forces of the Mont Pelerin Society. *Capitalism and Freedom* sold over half a million copies in the English language edition and was translated into eighteen different languages. The *TLS* rated the book one of the 100 most influential books since WWII. *Free to Choose* was the best-selling non-fiction book of 1980, and subsequently was translated into over 20 languages throughout the world. And, the TV series "Free to Choose" introduced these ideas to multiple generations through PBS distribution and later classroom use by professors.

Reception studies is an emerging discipline in intellectual history. I am not claiming to do a full "reception study" of *Free To Choose*, but instead a very select analysis to stress this point about the "tacit presuppositions of political economy". To do so, I am look at some highly select reviews to demonstrate the intellectual consensus that the Friedmans were challenging and to which they effectively countered and reversed. I have selected to highlight Robert Heilbroner's review in *New York Review of Books* entitled "The Road to Selfdom"; Kenneth Arrow's review in the *New Republic* and Christopher Lehmann-Haupt's review in the *New York Times*. I will also point to the professional consensus within economics circa 1980 as reflected in the review in the *Journal of Economic Literature*. The key issue to keep in mind, as the Friedmans themselves stress, is how the Great Depression framed the discussion in the minds of the intellectual class. I would also add that the previous era of late 19th century capitalism, and the first decade and half of the 20th century and the concern with monopoly, exploitation of the workers, the disregard for the health of consumers, and the general sense of economic and political injustice permeated the discussion among intellectuals and policy makers. Some of these concerns with laissez faire capitalism can be factually contested, and in fact it has been by a variety of economists and historians, but that is different than the wresting control of the tacit presuppositions. As I will stress throughout this essay, in our discussions over the power of ideas and lived historical experience we are always dealing with a problematic past and a troubling present. How scholars and intellectuals learn to disentangle the various causes from the obvious correlations, and utilize sound theory to get the factual record straight is always one of the most difficult and treacherous tasks of the social scientists. But it is a task we must undertake if we hope to improve our understanding of the human condition.

This is particularly true if we remember as Hayek taught us that economics is a uniquely *human science*, where we are what we study, and thus our purposes, plans, expectations, and actions make up our subject, and the object of our efforts must be primarily to render intelligible in terms of human purposes the social phenomena we purport to study, such as the marketplace. This means, as Hayek stressed, the facts of the social sciences are what people believe and think them to be. Thus, while framing effects are vital in all scientific and scholarly endeavors, they become that much more critical in the human sciences. As Fritz Machlup once put it, economics is a science just like the natural science except that in the economist's case "matter can talk". As we study the molecules and postulate the underlying principles of their motion and interaction, they speak back to us, and loudly if we care to listen. We are privileged as it were to be in this situation. The chemist or the physicist isn't so lucky to have this direct access to intentionality and thus the ultimate causal factor in their analysis of phenomena.

If all facts are theory impregnated as this implies, then all interpretations will be slanted in this or that direction requiring us to be very careful with our logic in our theoretical constructions and transparent with our data analysis. Clarity of exposition actually takes on a moral imperative in the human sciences if progress is going to be made, and strict rules of engagement must be adhered to otherwise the clash of ideas will result, not in a new consensus, but in the rather unproductive exercise of cataloguing arguments as right, left or center. Part of the motivation of Friedman's insistence that there aren't any schools of economic thought, but instead only "good economics" and "bad economics" was to overcome this tendency to catalogue one another rather than engage one another. But finding the best terms of engagements is often easier said than done.

One key idea can be attributed to Max Weber, who seemed to be faced with impossible barriers to conversation within the Germany academy. He suggested a simple rule of thumb; scholars should restrict their analysis to the logical coherence and empirical consequences of the use of certain chosen means for the attainment of given ends from the point of view of the advocate of those ends. In other words, scholars do not debate ends, but only the relative effectiveness of various means to the achievement of those ends. This was the path toward *positive analysis*, and enabled scholars to escape the endless quarrel over normative goals in social arrangements and public policy. In this way, social science could strive for objectivity in analysis, and thus be of service to mankind as a tool for social understanding, and as a critical guide in public policy.

It is not my purpose to enter into a long discussion of methodology of the social sciences by stressing both subjectivism and value-free analysis, but I thought it was important to put forward only because Friedman always couched his policy discussion in terms of value-freedom. His goal was to demonstrate that the frustration with various public policies was not because the intentions were unworthy. To the contrary, these public policy intentions were most worthy, but ill served by the policy means chosen to achieve those ends. I will come back to this shortly, but first let me just say that this emphasis on unintended consequences (both good and bad) was a major stumbling block in the real-time reception of *Free to Choose*. The book was a challenge to perceived aspirations of the New Deal and the Great Society not so much in terms of their aspirations for the public good, but for the inability of the chosen policy path to achieve that public good. Intentions, Friedmans argued, were not the same thing as achieving, and that is disturbing to the sensibilities of those who believe they have devised the right policy to fix the serious problems that have been identified. And, in fact, the Friedmans challenge was often harsher than mere ineffectiveness, but that the policies chosen actually exacerbated the social problem. Such a conclusion surely had to be incredulous.

Christopher Lehmann-Haupt (1980) begins his review in the *NYT* with a note that the Friedmans are part of a "small but preserving band of spokesmen who have adhered to the tenets of free enterprise ever since, and despite, the coming of the New Deal." In contrast to the teachings of Adam Smith and the contemporary doctrines of free enterprise, Lehmann-Haupt informs his readers that those of us "who have been raised at the foot of the New Deal have been taught that the manipulations of Adam Smith's invisible hand were not always so benign -- that ever since the Industrial Revolution began, the invisible hand produced a minority of victims -- the young, the old, the sick, the uneducated -- which became a majority with the coming of the Great Depression of the 1930s." He then pronounces simply that the "Friedmans pronounce this view of history a myth."

Lehmann-Haupt, after summarizing the argument in *Free to Choose* states that perhaps "10 or 20 years ago such arguments would be greeted by the public with all the seriousness reserved for a pamphlet picked up at Knott's Berry Farms."[2] But he quickly adds that today (circa 1980), it is obvious that the arguments found in *Free to Choose* have a "great deal going for them" in this historical context, and that he expects that the Friedmans will "open the debate." The position laid out in *Free to Choose*, Lehmann-Haupt states unequivocally can no longer be seen as some minority view.

In contrast, both Arrow (1980) and Heilbroner (1980) inform their readers that the Friedmans are incapable of presenting both sides of an argument. Heilbroner, unlike the *NYT* review starts by telling his readers that a "large number of people are yearning to hear" the message the Friedmans have to offer. The resentment that was once directed at Big Business is now directed at Big Government. Thus, *Free to Choose* is a book in tune with the times "whether the arguments and diagnoses are cogent or not." There are few among its potential readers, Heilbroner opinions, that will be willing to mull over the arguments presented, and instead will unfortunately take what the Friedmans have to say as a matter of faith. And Milton and Rose Friedman will not disappoint the faithful, as their argument on first read will appear to be one of "overwhelming logic" and "unanswerable evidence". The case made for the Smithian market and Jeffersonian government is completely convincing *until* one considers what is left out of the narrative constructed throughout *Free to Choose*. The Friedmans present only a one-sided argument and leave out any nuance and qualifications that would muddy the presentation. This tactic, Heilbroner argues, is so

[2] The Knott's Berry Farms reference is to the conservative political pamphlets designed to inform the general public about the benefits of free enterprise system that were on display at this famous theme park and store.

frustrating and disingenuous that reasonable critics are reduced to the position of just throwing up their hands. No room for reasoned discussion being left.

Rather than the history the Friedmans tell, what if, Heilbroner insists, we follow the great social theorists of capitalism such as Karl Polanyi and recognize that the capitalist system was not grounded in voluntary choices and mutual benefit. Instead, the modern capitalist system was a "product of a violent process of social displacement". Economists like the Friedmans can talk all they want about productive specialization and peaceful social cooperation in theory, but the capitalist reality is one of a "unstable and unwelcome structure of social and economic relationships." Capitalist society is far more dynamic and disruptive than the Friedmans want their readers to see, and they also smuggle in moral judgements without being explicit in their introduction according to Heilbroner. Due to disproportionate distributions of power in society, the simplistic voluntary exchange model conceals the need for countervailing forces in relations between management and labor, and between business and society if we hope to achieve a humane society. This is particularly damaging in the Friedmans discussion of equality, which in the end Heilbroner says, violates our sense of justice and violates modern conventions. Heilbroner sums up his opinion of the book as follows: "*Free to Choose* is to serious economic and political debate what fundamentalist preaching is to Bible scholarship."

Sadly, I would argue that Arrow's review is even more harsh in its assessment. Arrow's first complaint is that the Friedmans nowhere elaborate the costs associated with following their path to policy change given the current status quo, nor do they admit the possibilities of negative consequences that might follow in the wake of the adoption of their proposals. Arrow seems to imply that true professional economists have a moral responsibility to the public to be more circumspect and evenhanded in their presentation. The fact that the Friedmans do not is grounds for serious doubt in the exercise.[3] Furthermore, Arrow insists to his readers that they recognize that the Friedmans do not rely on the libertarian principles of justice and political economy one might find in say Robert Nozick's *Anarchy, State and Utopia*, so their case must rely on *economic reasoning*. *Free to Choose* does not contain a deontological case for freedom, but a utilitarian-consequentialist argument. But, Arrow is quick to point out, such an argumentative basis is far weaker defense of laissez faire. "They are also aware," Arrow writes, "that economic theory shows that the market cannot always be successful achieving efficiency." Externalities, public goods, monopoly power, macroeconomic instability, inequality, all ensure that markets fail to achieve ideal levels of efficiency in exchange and in production.

The various intellectual gymnastics that the Friedmans engage in to make their argument about the power of the market and the tyranny of controls, Arrow tells his readers, is littered with instances of fallacious argument making *Free to Choose* a "textbook example of false logical reasoning" and their lack of concern with questions of the distribution of income appear as "heartless". Lacking in logic and in compassion, unfortunately, the Friedmans also engage in a "cavalier" reading of economic history in the effort to make their case. Another serious flaw is that the work makes "no reference to the social reality of classes" except to indict the "new class" of bureaucrats, academics and journalists who benefit from government largesse. All the time making this argument, the Friedmans appear completely unconcerned with the dysfunctions in the market and in politics that results from concentrations in wealth. Arrow, in fact, uses the example of the Friedmans's skepticism toward government funding of science and their championing of

[3] One of the Friedmans's great strength is their constant willingness to take on the strongest criticisms of the market economy and to raise the comparative analysis of the self-correcting mechanisms of the market in the wake of a variety of imperfections, and the difficulties of implementing political solutions. Their book is a constant exercise in comparative institutional analysis between for-profit private sector, the non-profit private sector, and the public sector in addressing a variety of social ills. So reading Arrow's dismissal of *Free to Choose* for being unwilling to weigh both sides of the argument in economic policy and social philosophy just seems to be disingenuous.

private philanthropy and flips the argument, suggesting that private donors of science will bias the research in the interest of the donor rather than the pursuit of truth.

Overall Arrow ends his review of *Free to Choose* stating clearly that he was disappointed by the lack of a guiding principle to public policy deliberations, a failure to consider the costs of policy changes being proposed, and the one-sided selection of arguments and evidence in the presentation. In short, while there is value to be found in the Friedmans "itemization of government failures: industrial regulation that is primarily in the interests of the special interest groups regulated, inefficient post offices, disappointing schools, welfare 'messes,' the failure of public housing" this does not follow from their presentation of economic principles or the broad sweep of history that they provide. One must remember, Arrow states, that there is a long list of social problems related to the free market that *Free to Choose* simply fails to wrestle with. Though he doesn't explicitly say it, readers could easily be excused if the main take away from the review they got was that the book simply cannot be trusted, and as such, should be dismissed rather than debated.

I have belabored these reviews because they speak to the difficulties of getting the basic message the Friedmans want to offer to the intelligentsia of 1980. Their tacit presuppositions of political economy were just so at odds. For example, in Arrow's litany of social problems he lists questions about consumer lack of knowledge and labors weak bargaining power, and the claim remember is that the Friedmans supposedly do not address these issues. Yet, any close reading of *Free to Choose* would see immediately that these are central questions raised and answered in chapters 7 (Who Protects the Consumer?) and chapter 8 (Who Protects the Worker?). Moreover, starting with the introduction, the Friedmans constantly remind their readers that perfection in human affairs is simply not an option; we must face not only past imperfections, but future imperfections. There is no Dr Pangloss in the Friedmans view of capitalism. As they state: "in an imperfect world there were still many evils." (Friedman and Friedman 1980, xviii) The idea was to find a set of institutions that would disperse power, rather than concentrate it, and would minimize the downside risk of the imperfections of this world. There was a danger to strong government in terms of freedom and prosperity, and the checks on guaranteeing that only the "right people" would be in charge of that strong government were not as robust as wishful thinking had hoped. Wishful thinking is no substitute for hard-nosed analysis in political economy. The tensions in the liberal project, and the costs and benefits of social change, are stated clearly and weighed throughout -- from the introduction to the conclusion in *Free to Choose*.[4] Arrow just doesn't find the Friedmans's analysis persuasive, but that isn't how he argues. Instead, Arrow wants to insist that the Friedmans don't address these fundamental social questions. Why? It is my hypothesis that Arrow doesn't engage in the "reasonable individuals of good faith can disagree" sort of dialogue with the Friedmans because he cannot see their answers as ones within the reasonable set of possible answers to these serious social questions. The "taken for granted" bounds of reasonable opinion were established by Arrow in the post WWII consensus, and the Friedmans are challenging that consensus.[5]

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[4] In his *JEL* review of *Free to Choose* Donald Yankovic (1981) stresses this point. As he says, rather than being the one-sided argument that critics such as Heilbroner and Arrow claim the book has many instances where the Friedmans draw attention to counter arguments to their position (and he lists page numbers from the beginning to the end of the book). For the litany of dysfunctions of government regulations, there is also a litany of abuses in the marketplace that must be addressed. The Friedmans are calling for a comparative institutional analysis in *Free to Choose*. In his concluding paragraphs Yankovic sums up his understanding of the Friedmans argument as: "Whether self-protection and competition in markets, or the regulatory instruments of government are most appropriate to deal with these evils are areas of controversy. Reasonable men of good will can be expected to disagree. The book provides an excellent point of view for considering this issue. After all, one does not abandon the principle that liberty is always to be preferred when one is convinced by reasoning and evidence that certain evils of the marketplace are too great to expect even enlightened and virtuous citizens to cope with them." (ibid., 570)

[5] In 1982, *Capitalism and Freedom* was reprinted and Milton Friedman wrote a preface, where he states clearly that: "its views were so far out of the mainstream that it was not reviewed by any major national publication." It is "inconceivable that such a publication by an economist of comparable professional standing but favorable to the welfare state or socialism or communism would have received a similar silent treatment." (Friedman 1982, vi) My

III. Wresting Control of the Tacit Presuppositions

One must remember that *Free to Choose* is really the persistent and consistent application of basic economic reasoning to analyze the consequences of changes in public policy on the performance of the economy. The book building on *Capitalism and Freedom* also develops the argument about the interrelationship between economic and political freedom. The biggest differences in the central argument between the 1962 book and the 1980 book is the addition in the latter of ideas developed by F. A. Hayek on the nature of the price system and spontaneous order, and ideas developed by James Buchanan on the economic analysis of politics, or what came to be known as public choice and constitutional political economy. But boiled down to its bare essentials the Friedmans are simply asking that public policies be incentive compatible with basic economic motivations. Asking policy proposals to not require mythical beings populating the world for the policies to yield the results desired is not too big a logical leap. And the reality is that when the Friedmans sat down to write *Free to Choose* the stagnation and economic malaise was the reality that all were experiencing. Slowing growth and declining productivity raised doubt that private initiative could continue to overcome the dysfunctions caused by an overgoverned society. We were trapped in the unenviable situation where government grew because it failed, and it was continually failing because it was growing in scale and scope over the economic life of the people. The Friedmans were warning their audience that this growth of government and the politicization of our lives would eventually destroy both our prosperity and our freedom. Whereas Adam Smith

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point in quoting this passage from Friedman is not to highlight the bias in academia and media, but to suggest that the silent treatment was due to the tacit presuppositions. One example is the Friedman position on competition in schools and voucher programs, which at one time were considered unthinkable, then became widely appreciated, to now subject to efforts to discredit and delegitimize. From the tacit presuppositions of political economy perspective, the critical issue is what is considered in, and what is considered out, of the reasonable bounds of consideration. As those boundaries of the reasonable shift, so will the reception of challenging ideas.

taught us that individuals pursuing their own self-interest within a system of property, contract and consent could promote the general interest in society, the experience in the 30 year period following WWII demonstrated that "Individuals who intend only to promote the general interest are led by the invisible political hand to promote a special interest that they had no intention to promote." (Friedman and Friedman 1980, 281) Something had to change. *Free to Choose* provides the reader with some suggested constitutional changes that would in principle guarantee our economic and political liberties. But in following through consistently with their approach, the clash of ideas must be engaged first and the tide of opinion must be decisively turned. Milton and Rose Friedman believed that people were "waking up" and that individuals are "recognizing the dangers of an overgoverned society, coming to understand that good objectives can be perverted by bad means, that reliance on the freedom of people to control their own lives in accordance with their own values is the surest way to achieve the full potential of a great society." (ibid, 297)

The Friedmans were champions of clarity of exposition, so their argument is not too hard for anyone to hear, but as we have seen it was much more difficult to actually be listened to. Over the next decades the Friedmans message would not only be heard but would be listened to from China, UK and US to throughout the entire globe. Both *Capitalism and Freedom* and *Free to Choose* would influence political leaders and finance ministers, as well as dissidents and community activities to challenge the monopoly of power held by governments from the big debate over capitalism versus socialism to the smaller debate about public school versus choice in education. The direct and indirect influence Friedman exerted throughout the globe during the period 1980-2005 is simply staggering. (see Boettke 2004; Shleifer 2009)

Bob McTeer, former head of the Dallas Fed summarized the impact of Milton Friedman as follows:

> Friedman recognizes the power of the invisible hand of free enterprise to create wealth and jobs, while warning that the heavy hand of government will bring nothing but stagnation. He has argued for a monetary policy to stabilize prices and keep inflation low. Most important, Friedman has made economics a moral matter as well as one of productivity, jobs, and growth. Economic freedom, he reminds us, is every bit as precious as the other freedoms we treasure.

During the period between 1962 and 1980, one can see slow but persistent changes in the standard textbooks in economic where Friedman's ideas are presented to students from the elementary to the advanced level. The Keynesian consensus breaks down in theory and practice, and central planning is rejected as a guiding principle for developed and developing economies.

The tacit presuppositions of political economy by 1990 were decidedly shifted away from the taken for granted notions of inefficiency, instability and injustice of capitalism to one that saw capitalism as the creative force behind wealth creation and the tearing down of monopolistic privilege through entrepreneurial innovation. Socialist presumptions that had so influenced what intellectuals believed from the late 19th and most of the 20th century, were pushed into the background during the age of Milton Friedman. It would be difficult for me to argue that they disappeared, as the resentment toward the bourgeois class, and the fear of market exploitation and market instability were omnipresent in the educational establishment as well as in popular culture. It remained the case that the greatest fear of capitalism was mass unemployment, and the greatest resentment of capitalism was the idle rich. It was just that the typical answers that were given ever since the Great Depression, were worn out explanations, and the contending perspectives of monetary mischief by Central Banks was treated as worthy hypothesis to be reckoned with in empirical investigation of macroeconomic volatility and economic growth.

There was during the 1960s and 1970s a renewed appreciation for the power of the market and the dysfunctions of political intervention in the market with respect to wage and price controls, industrial organization and anti-trust, and social programs and fiscal responsibility. In many ways by the late 1980s, all of Milton Friedman's basic ideas with respect to public policy and the power of markets and the tyranny of controls were accepted as within the realm of reasonable opinion. And the seismic changes that took place in the 1980s culminating in the collapse of communism and the transition to capitalism must never be understated. Friedman's ideas were influencing public discourse and policy initiatives from China to Estonia, and from the Nordic countries to Latin America.

But as the 1990s progressed and the difficulties of post communism became more obvious Friedman himself began to question the lesson to be learned from this experience. First, he stressed that while he sincerely believed that, in the realm of ideas, the basic Smithian program he presented had won the day based on impeccable logic and unimpeachable evidence, he did admit that market oriented thinkers of the conservative and classical liberal variety had often lost the battle of public policy implementation. This was critical because lesson #1 in public policy was to adopt incentive compatible policies, but lesson #2 was pursue incentive compatible strategies for the implementation of strategies. As Dennis Robertson wrote years earlier, if for our explanations in political economy we rely on the benevolence of the actors to achieve the outcomes, we will both be left waiting forever to achieve the desired outcomes, and exhaust the benevolence that actors actually have in their possession in the futile effort to achieve those outcomes. Alternatively, rather than requiring sacrificial beings, if we instead rely on the ordinary motives of men and women, and seek ways to align incentives in a way where doing good is consistent with achieving good, and avoid those situations where we end up doing bad by doing good (see Coyne 2013). If we align incentives right, then we can escape the dysfunctions of the overgoverned society, and realize the "Good Society" that Walter Lippmann, F. A. Hayek, and Milton Friedman all talked about. But by failing to win the day on implementation, the contradictions and conflicts of the transition period have come to define the experience of the 1980 to 2005 era as much as the great growth in wealth and generalized prosperity.

Real existing capitalism does exhibit cronyism as well as creative destruction. That empirical reality in the 2000s created impressions and issues in sustaining the control over the tacit presuppositions of political economy along the lines the Friedmans fought so hard to pull in their direction. This was solidified after the global financial crisis in 2008, and the policy responses followed over the past decade in response. Those in politically privileged positions were presumed to be bailed out, while those who lacked political privileges access were left to fend for themselves in the hyper competitive world of global capitalism. The tacit presuppositions reversed back, I am arguing, to the pre-*Free to Choose* era, and that presents the challenge we must all face today.

IV. The Challenge of Our Age

As a 19 year old in my second year of college, but repeating my freshman year over, I was exposed to economics. The year was 1979. What was my experience with the world, not on the black board, but out the window? First, the 1970s were difficult times economically and politically. Prior to my teens, I did experience the turbulent times of the 1960s, but as a child would. I grew up just outside of Newark, NJ in the suburbs, and my grandparents lived close to Asbury Park down at the Jersey shore. My youth saw friends' older brothers sent off to fight in Vietnam, others who missed the draft because of college deferment, and many older siblings that started to question the entire purpose of the Vietnam War and the social conventions of their parents. Watergate followed, and Nixon, Ford and then Carter were objects of ridicule more so than symbols of leadership and hope. The images, for good or bad, from my youth are of Nixon saying "I am not a crook" and his flying off in the helicopter after he was forced out of office in disgrace; of Ford, a former All American college athlete, stumbling down the stairs of Airforce One; and Carter appearing on TV in a cardigan sweater invoking the Boy Scouts to check the thermostat in your home to keep so as to not waste natural gas. Seriously, that happened! Combine that with stagnating economy with high unemployment, with inflation, and with long lines to get gasoline.

When I sat in economic and was introduced to basic supply and demand it was as if I had been given a magic set of eyeglasses that now allowed me to see the world as it was and it gave me a sense at the ripe old age of 19 that I was starting to understand how the world worked. My "taken for granted" presuppositions were forged in a world where New York City was bankrupt, where the US economy was stagnant, and our politicians were corrupt at worse and buffoons at best. Communism did not offer an alternative as they cheated in sports, and were led by an old and decrepit cadre starting with Brezhnev. Just as described by the Friedmans, the world in which I was educated in economics was the opposite from the world that Depression era college students experienced. The intellectuals educated in the 1900-1950 period saw monopoly exploitation, financial speculation lead to ruin, mass unemployment, and gross social injustice. I saw those things as well, but rather than seeing the source as emanating from the acts of voluntary market exchange I came to see them as the natural by-product of government policies which produced perverse incentives and distorted signals, and which when studied in-depth favored particular groups at the expense of others. Between 1979 and 1999, my studies and my experiences reinforced these priors. It was my taken for granted picture of the world. The Friedmans helped produce that, but they were not alone, and they were certainly aided in that framing by the lived reality of economic and political life both in the US and abroad.

When I started teaching economics, most of my students had that same experience. I taught my first classes on my own in 1985, and the youngest person in that class would have been born around 1968. When I moved to GMU in 1998, my youngest students would have been born around 1980. They had all witnessed in their lives the collapse of communism, the birth of democratic countries, and the economic wealth created by globalization. But by 2008, those students were born around 1990, and their taken for granted background had shifted. They grew up during the era of tensions in the middle east, the difficulties with post communism, the protests against globalization, and a growing concern with climate change. What they don't have any lived memory of is the failure of communism and the hope of post-communism. Fast forward to 2019, and those students were born around 2002. What they know is not the shock of 9/11, but the experience of a permanent war economy. They were coming of age intellectually when the global financial crisis hit, and more accurately after the narratives about that crisis were formed. This current generation, at least some of them, have grown up believing that wealth is ill-gotten due to privilege or due to pure random luck, that the wealthy are too myopic to consider the future costs of irreversible climate changed, that markets are plagued by inefficiency, instability, and injustice. The global financial crisis in immediate impact might have been closer to the 1970s stagnation than the 1930s financial ruin, but a decade later and the impact on those "tacit presuppositions of political economy" are in fact closer to the 1930s.

The Friedmans had a framework for understanding why the promise of the 1980s gave way to the frustrations experienced with stalled and failed reforms in their book *The Tyranny of the Status Quo* (1984). The great awakening to the dangers of overgoverned society was only an idea awakening, but the reality of political change means defeating the "iron triangle" of interests that form during the period of government growth and benefit from the existing political arrangement. (ibid., 165ff) Unfortunately, their work on the frustrations with market reforms did not resonate with readers as their earlier work did. The cronyism of the capitalism that the current generation of youth identifies with the US economic system is a reality. We live in the rent-seeking society that Buchanan, Tollison and Tullock (1980) warned of, and which Randy Holcombe (2018) and Michael Munger (2019) have respectively diagnosed recently. Promissory politics leads to predatory governments, just as the Friedmans taught, but the challenge of our age is that the young see the predation in the seeking of protection of privilege by business interests, rather than in the politicians, bureaucracy and intellectuals who seek to expand the power of the state by securing those privileges for those monied interests.

One way to think about this that might help and highlight the challenge we face as educators, scholars and communicators is to parse the issue of predation. We can all agree that predation is a fundamental problem in political economy. From Adam Smith's *The Wealth of Nations* to Daron Acemoglu and James Robinson's *Narrow Corridor* (2019) the problem of curbing predation is fundamental in understanding the political economy of development, and of a achieving a good society defined as one of religious, political and civil liberties and generalized prosperity -- in short, a society defined by productive specialization and peaceful social cooperation. Predation comes in the form of *private* predation, as individuals exercise their power over others, and exploit them to their advantage. But predation also comes in the form of *public* predation, where those in positions of power use the full force of the law and the apparatus of coercion (including police and military) to rule over others and make them subjects rather than citizens. And here is the puzzle, in order to curb private predation, we create public authorities to police us, but in so doing we create the very possibility of public predation which we then must keep in check through constitutional efforts that must empower yet constrain. Again, political economists from Adam Smith to Daron Acemoglu and James Robinson all understood this fundamental paradox of governance.

But where the tacit presuppositions of political economy kick in is not in recognizing this conundrum, but in our priors about the resolution to it. For ease of exposition, let's limit the discussion strictly to the question of optimism and pessimism about the ability for private governance to self-police private predation, and the ability of constitutional checks and balances to effectively bind the governmental habit of public predation. Because of the frustrations with the failed policies of the 1960s and 1970s, and demonstrated in the stagnation of the late 1970s, when the Friedmans wrote *Free to Choose*, the tacit presupposition of my generation was that private predation would be easier to self-police than checking public predation via constitutional constraints. To this generation, however, I contend it is the opposite, and namely because the faith in curbing government predation isn't to be found in constitutional restraint but in the selection of "right people". The only thing preventing this right people answer, according to this now common narrative, is the willful and corrupt action of political opponents to fix the rules of the election, or manipulate the minds of voters through misinformation and sowing confusion and/or discord. As a result we are prisoners to a political system populated by evil people empowered by stupid people who have been manipulated by those in power and the monied interests who work with them. If more people were allowed to vote, and if more voice was given to the voiceless, we would see more power transfer from the powerful to the powerless, and the public sector would reflect true democratic values of fairness and justice. We are one another's dignified equals, except when we lie, cheat and steal to get what we want. So, if we eliminate the lying, the cheating, and the stealing, what we get from democratic processes is what we will want -- presumably a more just and humane society.

For those of us who believe in liberal political economy, we have a challenge, and the only way to meet this challenge head on is to strive to be scientists, educators and communicators at the

Friedman level of clarity of argument and carefulness and thoroughness in empirical analysis. It requires patience, devotion to craft, and quickness of mind and gentleness of spirit. Friedman was a unique talent, and the skill set he exhibited must be adapted to our present age, but it must be displayed by many if there is any hope of turning the tide again. With great challenges comes a great opportunity for those prepared to take advantage of it. The best thing MPS has done over the past decade, in my opinion, is to cultivate programs for the next generation of thought leaders, and from within that crowd perhaps will emerge precisely that pivotal person for these pivotal times. In terms of our global reach and recruitment of young scholars, often from previously underrepresented fields and locations, MPS is attempting to discover those talented scholars, educators, public intellectuals, and policy makers that are up to the challenge. This is something we must continue to do and do even better over the next decades if we are to meet the challenges of our age.

V. Conclusion

It will do no good in our effort to engage the current generation and to wrest back control of the tacit presuppositions of political economy to deny the problems they see as critical to the world. On issues from racial injustice to environmental degradation, we must be willing to grapple as Milton and Rose Friedman did in *Free to Choose* with the imperfections of this world and thus the great evils that are revealed. The political and economic systems of the western democracies suffered from perverted incentives and distorted signals, and, as a result, the market process does not operate as it should to spur enterprise, to guide actors in their decisions, to lure them with profit, and to discipline them with loss. The power of the market has been muted, while the tyranny of controls has expanded since 9/11 and 2008.

There is much wisdom in Adam Smith's argument that great nations are never ruined by private misconduct, but they can be by public misconduct. Smith was also right to stress that the power of innovation can quite often overcome the impertinent obstructions which government erects to hinder productive specialization and peaceful social cooperation. As he wrote in *The Wealth of Nations*: "The uniform, constant, and uninterrupted effort of every man to better his condition, the principle from which public and national, as well as private opulence is originally derived, is frequently powerful enough to maintain the natural progress of things toward improvement, in spite both of the extravagance of government, and of the greatest errors of administration. Like the unknown principle of animal life, it frequently restores health and vigour to the constitution, in spite, not only of the disease, but of the absurd prescriptions of the doctor." (see Smith 1776, Book II, Chapter 3, 325) But there also must be a tipping point where the perversity of the incentives and the distortions in the signals are so significant and the deformation of the economic system is so severe that the correction cannot avoid being deeply problematic and painful. As liberal thought leaders, are we prepared to grapple with the fall out of the bad public policies our own analysis has warned us about for decades?

We must always remember as true radical liberals that we inherited a problematic past, and a troubling present. Kant told us, and Berlin adopted it as his motto, that out of the crooked timber of humanity nothing straight can ever be made. We are imperfect beings living in an imperfect world stumbling along with the aid of very imperfect institutions. As liberals how we respond to this will dictate our success. Buchanan (1991) explained how the great classical liberals of the 19th century missed their opportunity due to their failure to develop a theory of justice that answered the challenges of their day. Frank Knight pondered on multiple occasions whether liberals would have the intellectual courage and wherewithal to meet the challenge created by the

Great Depression and the communist and fascist threat. And, of course, Hayek spent the second half of his career trying to answer this challenge and it largely motivated his efforts with the Mont Pelerin Society. We as heirs to this intellectual project can do no less.

This is a Special Meeting of the Mont Pelerin Society celebrating the 40th anniversary of a meeting held on these grounds in 1980. That meeting was held at the cusp of a revolution spearheaded by Milton and Rose Friedman's *Free to Choose*, and it ushered in "The Age of Milton Friedman". It is right that we celebrate this chapter in our society's past. But as we meet today, we must remember our situation intellectually is less like 1980 and more like 1938 (Colloquium Walter Lippmann) or 1947 (Mont Pelerin). The tacit presuppositions of political economy have shifted once more and away from our ideas. Books are continuously released these days criticizing Mont Pelerin Society, and in broader strokes, the entire economics profession in its complicity with regard to the global financial crisis, the prioritizing capital over labor and democracy, and the preoccupation with growth over the environment. Each day new studies in the New History of Capitalism are published, discussed, and built on in history, philosophy, political science, sociology, cultural studies, communications, global affairs, and area studies departments. In short, economics has been effectively surrounded by all the associated disciplines in the social sciences and humanities by critics. The reality is that not all the criticisms are wrong, and many, in fact, are right. But practically speaking, the reality is that any argument from within economics that hopes to effectively counter must begin with where they are, not where we are.

Hayek's career is instructive from this point of view. When he moved to LSE in the early 1930s, he gave as his inaugural address "The Trend of Economic Thinking", and a major lesson of that address is that if you think like a neoclassical economist, then the arguments for planning will appear very problematic to you. (see Hayek 1933) Only those who reject economic way of thinking could advocate for such a path. Unfortunately for Hayek, by the end of the 1930s, the standard argument for planning was couched precisely in the most neoclassical of language. This led him, I argue in my recent book on Hayek (see Boettke 2018) to make two simultaneous turns in the 1940s away from technical economics and toward (1) the examination of the institutional framework within which economic life takes place, and (2) the philosophy of science, which due to a wrong turn, had turned a blind eye toward the institutional framework and the essential dynamic nature of market system and, in particular, the guiding role of relative prices and the functional significance of profit and loss accounting. Hayek's great discoveries in economics as reflected in works such as "Use of Knowledge in Society" (see Hayek 1948) as well as his political books such as *The Road to Serfdom* (1944), *The Constitution of Liberty* (1960), and *Law, Legislation and Liberty* (1973, 1976, 1979) all follow from this research path he was forced to embark upon with his examination of the "Abuse of Reason". (see Hayek 1952) For our purposes, however, it is important to stress that Hayek took this intellectual journey not alone, but with his fellow members of the Mont Pelerin Society Liberal political economy was reconstructed with their hands from 1947 to 1980 culminating in so many ways with the publication of the Friedmans's *Free to Choose* and the 1980 meeting at Hoover that we are celebrating with this special gathering.

In conclusion, I want to suggest that those here at this meeting must continually learn from the Friedmans, and from Hayek, and from Buchanan, but apply those lessons to our age, and the challenges we face today with the same creativity and commitment that these great intellectual leaders did. Respectfully, I want to suggest that the challenges the next generation of thought leaders must face are more difficult than those faced in the period of 1970-1980. The students sitting in our classrooms today do not have the same taken for granted lived experiences that I had.

They don't know in their heart of hearts that 'socialism sucks'; that government is 'a parliament of whores'; or that the welfare state is 'losing ground'. They believe they know that markets are inefficient, unstable and unjust. They believe in their heart of hearts that markets are corrupting of our morals, and destructive to the 'good society'.[6] Thus, now more than ever we must remember Hayek's words by which he began *The Constitution of Liberty* (1960, 1):

> If old truths are to retain their hold on men's minds, they must be restated in the language and concepts of successive generations. What at one time are their most effective expressions gradually become so worn with use that they cease to carry a definitive meaning. The underlying ideas may be as valid as ever, but the words, even when they refer to problems that are still with us, no longer convey the same conviction; the arguments do not move in a context familiar to us; and they rarely give us direct answers to the questions we are asking. This may be inevitable because no statement of an ideal that is likely to sway men's minds can be complete: it must be adapted to a given climate of opinion, presuppose much that is accepted by all men of the time, and illustrate general principles in terms of issues with which they are concerned.

It is now up to the next generation of scholars, educators and communicators involved with Mont Pelerin Society to do the heavy work of restating and reconstructing the liberal principles of justice and political economy and offer a vision of the good society for our times. Let's hope that among you there is someone, and hopefully a number of you, that is as clear of thought, firm in their convictions and as convincing in argumentation as Milton and Rose Friedman were in *Free to Choose*.

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[6] I recommend most enthusiastically the book by Virgil Storr and Ginny Choi (2019) on *Does the Market Corrupt Our Morals?* In tone and attitude, I believe this book is a model of how to engage today's students in a way that might persuade them of the merits of the market society. I would also recommend Paul Rubin's (2019) recent book *The Capitalism Paradox* for similar reasons.

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The Spread of Free-Market Ideas in the 1980s (With a Nod to the Late 1970s)

David R. Henderson[1]

> It started with Sir Keith [Joseph] and me, with the Centre for Policy Studies, and Lord Harris, at the Institute for Economic Affairs. Yes, it started with ideas, with beliefs. That's it. You must start with beliefs. Yes, always with beliefs.
> --Margaret Thatcher, quoted in Daniel Yergin and Joseph Stanislaw, *The Commanding Heights*, 1988, p. 124.

The Economic Setting and Some of the Results

The years from 1978 to the early 1980s were an exciting time for believers in liberty. Pro-freedom ideas were percolating in the United States, in the United Kingdom, and even, although we didn't know it then, in China.

Compare that to the early to mid 1970s. In the United States, a Republican president whom some in this Society, including me, worked for, imposed economy-wide price controls in 1971. Those controls were in force in 1973 when OPEC almost quadrupled the price of crude oil. The results were tremendous shortages of oil and gasoline, a central planning agency that allocated gasoline, and, under Presidents Ford and Carter, some serious intrusions into people's freedom to buy the kinds of cars and kitchen appliances they wanted. Although the price controls are long gone, those intrusions remain.

Marginal tax rates on individuals were high and rising as inflation put even middle-income people into tax brackets that had been reserved for very high-income people. In Britain, the top tax rate on "earned" income was 83 percent and on so-called "unearned" income was a whopping 98 percent. In the mid-1960s, the latter rate was 95 percent, a fact that led one of its victims, Beatle George Harrison, to write *Taxman* whose opening words got the marginal tax rate exactly right:

> Let me tell you how it will be
> There's one for you, nineteen for me
> 'Cause I'm the taxman, yeah, I'm the taxman.

In the United States, the top tax rate was 70 percent.

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But in the late 1970s, there was a growing movement in the United States and Britain to reduce tax rates. In the United States, economists such as Alfred Kahn and Murray Weidenbaum were critiquing government regulation and Kahn was chosen as head of the Civil Aeronautics Board, where he used his discretionary power to reduce regulation of airline routes and fares and used his persuasive powers to argue for legislation to deregulate airlines.

In both the United States and Britain, marginal tax rates at all income levels, but particularly at the top, were reduced in stages. Ronald Reagan, along with a bipartisan Congress, brought the top tax rate down from 70 percent to 50 percent and, later, to 28 percent. In Britain, Margaret Thatcher's government reduced the top rate on earned and unearned income to 60 percent and, later, to 40 percent.

In Britain, Prime Minister Margaret Thatcher, after winning reelection in a landslide in 1983, proceeded to take on the powerful strike-prone National Union of Miners, which had a monopoly on labor for the government-owned coal mines, and then to privatize a large number of government-owned firms and industries. By 1990, her last year as Prime Minister, for every thousand people working, only 108 work days were lost to strikes, a 93 percent drop from 1979 when she took office. By 1992, 46 major businesses, with 900,000 employees, had been privatized and, instead of draining taxpayer funds, were generating tax revenues.

In China, after the brutal dictator Mao Zedong's policies had killed tens of millions of people, the good news was that in 1976, he died. His successor, Deng Xiaoping, broke with Mao's socialist policies. Pushed by farmers protesting collectivist agricultural policies during a severe drought in 1978[2], he implemented reforms to let them keep more of what they produced. This gave the incentive to produce more. Later in the 1980s, Deng implemented economic reforms in the industrial sector that produced what he called "building of socialism with Chinese characteristics." That was a euphemism for an economy in which private property was more respected than it had been and people were freer to produce and keep a substantial portion of the proceeds from their production. The result was a few decades of high economic growth in which hundreds of millions of Chinese people were rescued from poverty.

The Intellectual Revolution

For policies to change, it is typically necessary for ideas to change. How did some of the key decision makers come to believe in freedom more than their predecessors did? There seem to have been two main ways. One is that those who didn't believe in freedom saw evidence that is so striking that they change their minds. The other is that they are persuaded on a more abstract level by those who believe in freedom and then start seeing confirming evidence in the world. Both are important.

[2] See Kate Zhou, *How the Farmers Changed China*, Westview Press, 1996. The title says it all, but the story is fascinating. Zhou gives credit where credit is due.

And both are what happened in large parts of the world to very influential people in the last 40 to 50 years. Daniel Yergin and Joseph Stanislaw, in their book *The Commanding Heights*[3], tell many of the stories. The subtitle carries much of the book's message: "The Battle Between Government and the Marketplace that is Remaking the Modern World."

Two important political players in Britain were Margaret Thatcher and Sir Keith Joseph. In the 1970s, they had both come to believe in economic freedom, partly from observing the low-growth, high-inflation mess that was the British economy and partly from reading. Three of the thinkers who inspired them were our founding member, Friedrich Hayek, and two other Mont Pelerin members, Ralph Harris and Arthur Seldon. Joseph, a member of the British Parliament in the 1970s, showed up at the Institute of Economic Affairs in London, where he met Harris and Seldon, who were kind of the John Lennon and Paul McCartney of British classical liberal economic thinking. Harris and Seldon, in turn, pushed the works of Friedrich Hayek and Milton Friedman. Incidentally, sometime in the mid-1970s, while Thatcher led the Conservative Party, she had a private visit with Hayek at the offices of the Institute of Economic Affairs. After she left, the IEA staff gathered around Hayek to ask his impressions. Not normally at a loss for words, Hayek answered simply, "She's so beautiful."

One of Joseph's most important talks was his 1976 Stockton lecture, "Monetarism is Not Enough."[4] In that talk, later made into a pamphlet, Joseph argued that while monetary policy was the appropriate way to reduce inflation, it was not the appropriate way to deal with the supply-side problems in the economy. For those problems, he argued, the British government needed to reform taxation, regulation, labor policy, etc.

Sir Keith Joseph, by the way, gave a talk at this very meeting in 1980, just over a year after his Conservative Party had taken power. I recall his explaining the difficulty of selling off government enterprises, such as British Steel, that were losing money. He argued that the government needed to turn them into profit-making enterprises before they could be sold. I pointed out that that might mean they would never be sold. David Friedman, if I recall correctly, said something similar. But the best line, which Hannes Gissurarson reminded me of, came from Gordon Tullock, who yelled out, "I'll buy it for a dollar."

In the United States, numerous intellectual developments in the direction of freedom began in the late 1970s and flourished in the 1980s. The most important player was Milton Friedman. Friedman argued that growth in the money supply was responsible for inflation and that there was no permanent tradeoff being inflation and unemployment. Friedman articulated the latter view in a famous lecture as president of the American Economic Association in 1967; Hayek, by the way, had stated that view a few years earlier, arguing that the only way to keep unemployment artificially low was to have higher and higher rates of inflation. Also important in the realm of ideas was Milton and Rose Friedman's *Free to Choose*,[5] based on the 10-part

[3] Daniel Yergin and Joseph Stanislaw, *Commanding Heights*, Simon & Schuster, 1998.
[4] It can be found here: https://www.margaretthatcher.org/document/110796
[5] Milton and Rose Friedman, *Free to Choose*, Harcourt, Brace, Jovanovich, 1980.

PBS series of 1980, which sold hundreds of thousands of copies. In that book, the Friedmans made their case for rolling back government intervention in the economy.

And just as Hayek was important in Margaret Thatcher's intellectual development, so Milton Friedman was important in that of Ronald Reagan. Reagan shared many of Friedman's views and, in his own right, was a public intellectual. During his six years between being governor of California and becoming U.S. president, Reagan delivered hundreds of radio addresses in which he often laid out free-market views.[6]

Many other economists, not just members of the Mont Pelerin Society, contributed to the case for freedom and were also active in actually reducing taxation and regulation.

On taxation, consider the "supply siders." While many mainstream economists dismiss them, their key insight was that an x percent reduction in tax rates leads to less than an x percent, and possibly much less than an x percent, reduction in tax revenues. In the extreme case—and most of the supply-siders were careful most of the time not to be extreme—a reduction in tax rates can lead to an increase in tax revenues. In 1978, Seymour Zucker of *Business Week* wrote:

> To Harvard's Martin Feldstein, the theoretical principle that at some point reducing rates actually increases revenues is something we teach in the first week of Public Finance.[7]

But even though many economists were aware of the insight, they didn't apply it. Most economists in the late 1970s who estimated the effects of cuts in income tax rates assumed that an x percent cut in rates would lead to about an x percent cut in revenues. It took supply siders like Arthur Laffer, Alan Reynolds, Bruce Bartlett, and Paul Craig Roberts[8] to take the supply-side insight and run with it. It was that thinking that helped lead to Ronald Reagan's 1981 tax cut, which dropped the top marginal tax rate from 70 to 50 percent, a drop of 29 percent, and dropped most other marginal tax rates by 23 percent over three years. And although we never did achieve a flat income tax rate, as advocated by Hoover fellows Bob Hall and Alvin Rabushka, their 1985 book, *The Flat Tax*[9], helped get us part of the way there with the 1986 Tax Reform Act, which cut the top income tax rate to 28 percent.

Another major success was in deregulation of airlines, trucking, and telecommunications. In their book, *The Politics of Deregulation*[10], political scientists Martha Derthick and Paul Quirk tell the fascinating story of how that came about in the late 1970s. Because of the scholarly work critical of regulation and because of the publicity much of this work was given, the view that

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[6] Many of them are collected in Kiron K. Skinner, Annelise Anderson, and Martin Anderson, *Reagan, In His Own Hand, Free Press*, 2001.
[7] Seymour Zucker, "Commentary/Economics," *Business Week*, August 7, 1978, pp. 62-64.
[8] Roberts gave a paper on tax policy at the 1980 Mont Pelerin Society meetings at Hoover.
[9] Robert E. Hall and Alvin Rabushka, *The Flat Tax*, Hoover Institution Press, 1985.
[10] Martha Derthick and Paul J. Quirk, *The Politics of Deregulation*, Brookings Institution Press, 1985. For those who want to understand how deregulation came about, I highly recommend this book.

economic freedom in the airline industry was good and regulation was bad became widespread among not only academics but also among policymakers in the Gerald Ford and Jimmy Carter White Houses, in Congress, and even among some regulators. A number of lawyers and economists joined the cause. One important lawyer was Stephen Breyer, now on the Supreme Court, who persuaded Senator Edward Kennedy to make it one of his major issues, as he prepared to run for the Democratic presidential nomination of 1980. Carter-appointed Civil Aeronautics Board (CAB) chairman Alfred Kahn, the most prominent economist involved, worked both on Capitol Hill and in the regulatory agencies to achieve more economic freedom in the industry.

One key figure in deregulating airlines who was less well known was Roy Pulsifer, an assistant director of the CAB's Bureau of Operating Rights. The economics literature persuaded him and he pushed internally for deregulation. Derthick and Quirk write, "When we interviewed him in his office in the CAB in 1980, he had become a radical libertarian, with a picture of the famous free-market economist, Milton Friedman, displayed on his desk."

Interestingly, the airline deregulation story illustrates that the public choice view of regulatory agencies being captured by the industry they regulate is not the whole story. It was precisely staffers and commissioners in the CAB who pushed for deregulation.

The Revolution in Thinking about Socialism

More important than the controversy over taxation and regulation was the big-picture issue: socialism versus the free market. In two important ways, there was a revolution in thinking away from socialism. The first was among economists. Two of the original members of the Mont Pelerin Society, Ludwig von Mises and Friedrich Hayek, had written about the impossibility of using centralized planning to run an economy well. In his 1922 classic, *Socialism*, von Mises wrote:

> Separate accounts for a single branch of one and the same undertaking are possible only when prices for all kinds of goods and services are established in the market and furnish a basis of reckoning. Where there is no market there is no price system, and where there is no price system there can be no economic calculation.[11]

Hayek emphasized the same point, laying it out beautifully and using some concrete illustrations and one nice metaphor, in his 1945 article "The Use of Knowledge in Society[12].

[11] Ludwig von Mises, *Socialism*, Yale University Press, 1951, p, 131. (Translated from *Die Gemeinwirtschaft*, originally published in 1922.)

[12] Friedrich A. Hayek, "The Use of Knowledge in Society," *American Economic Review*, Vol. 35, No. 4, September 1945, pp. 519-530. On line at: https://www.econlib.org/library/Essays/hykKnw.html

In 1945, Hayek was a voice crying in the wilderness. But in 1978, in his opening speech at the Mont Pelerin meetings in Hong Kong, Hayek was optimistic. Hayek thought that it was becoming clear that socialism was on the defensive and he called for a grand debate in Paris on socialism versus capitalism. His proposed resolution was "Resolved that coercion is a good way to organize an economy." In the question period, I said I thought it was a great idea but no socialist would admit that he was advocating coercion and my friendly amendment was that he should come up with a more-neutral word. He said he would consider it.

Two years later, Milton Friedman devoted his whole speech[13] to the Mont Pelerin Society here at Hoover to the issue of socialism and economic calculation. One reason he stated for the issue's importance was this:

> I believe further that the acceptance of the feasibility of the existence of an autonomous socialist society is an underlying and prior condition to the acceptance of the welfare state, and not the other way around.

Friedman also stated:

> The problem of, and the debate on, economic calculation as it was referred to in the 20s and 30s has turned out to be the best kept secret in the world of economic thought.

The debate that Hayek had proposed in 1978 never happened, but it didn't need to. It's true that as late as 1989, Paul Samuelson and William Nordhaus wrote in their textbook *Economics*:

> The Soviet economy is proof that, contrary to what many skeptics had earlier believed, a socialist command economy can function and even thrive.[14]

But something more momentous happened that same year and the next year. One of the America's most-famous socialist economists admitted that von Mises and Hayek had won the debate. That economist was Robert Heilbroner. In a 1989 article in the *New Yorker*, Heilbroner wrote:

> Less than 75 years after it officially began, the contest between capitalism and socialism is over: capitalism has won…. Capitalism organizes the material affairs of humankind more satisfactorily than socialism.[15]

And in a 1990 article in the socialist publication *Dissent*, Heilbroner gave credit where credit was due, writing:

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[13] I found his copy of the address in the Hoover archives.
[14] Paul A. Samuelson and William D. Nordhaus, *Economics*, 13th ed. McGraw-Hill, p. 837.
[15] Robert Heilbroner, "The Triumph of Capitalism," *New Yorker*, January 23, 1989.

> But what spokesman of the present generation has anticipated the demise of socialism or the "triumph of capitalism"? *Not a single writer in the Marxian tradition!* Are there any in the left centrist group? None I can think of, including myself. As for the center itself—the [Paul] Samuelsons, [Robert] Solows, [Nathan] Glazers, [Seymour Martin] Lipsets, [Daniel] Bells, and so on—I believe that many have expected capitalism to experience serious and mounting, if not fatal, problems and have anticipated some form of socialism to be the organizing force of the twenty-first century.
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> … Here is the part hard to swallow. It has been the Friedmans, Hayeks, von Miseses, *e tutti quanti* who have maintained that capitalism would flourish and that socialism would develop incurable ailments. Mises called socialism "impossible" because it has no means of establishing a rational pricing system; Hayek added additional reasons of a sociological kind ("the worst rise on top"). All three have regarded capitalism as the "natural" system of free men; all have maintained that left to its own devices capitalism would achieve material growth more successfully than any other system.[16] (italics in original)

Game, set, and match to von Mises, Hayek, and Friedman.

Incidentally, in the first edition of my encyclopedia, *The Fortune Encyclopedia of Economics*, I had Heilbroner write the entry on socialism. In the first draft he sent me, he wrote that one of the reasons he and others felt right about dismissing Mises and Hayek's criticisms in the 1940s was that they were nasty people. As an editor, I typed a query: please explain this claim. When the next draft came back, the explanation was lacking but, interestingly, so was the claim.

The other important revolution in thinking about socialism was among Asian politicians. In Asia in the late 1970s and 1980s, some important government officials dropped their belief in socialism simply by paying attention to physical reality.

The most important player was Deng Xiaoping. In 1978, as mentioned earlier, Chinese peasants, faced a severe drought. They were unwilling to break through the hard land for the sake of a collective owner, and pleaded with communist leader Deng Xiaoping to allow each family to keep all production, in excess of a low quota, on the land they tilled. Deng allowed it, creating a de facto system of property rights and an implicit marginal tax rate of zero. The result: between 1978 and 1990, the share of agricultural output sold in open markets rose from 8 percent to 80 percent and in the six years after 1978, real income in farm households rose by 60 percent. Deng also allowed more freedom to companies located in Special Economic Zones

[16] Robert Heilbroner, "The World After Communism," *Dissent*, Fall 1990, pp. 429-430. Quoted in Robert Heilbroner, "Socialism," in David R. Henderson, ed., *The Concise Encyclopedia of Economics*, Liberty Fund, 2008. At: https://www.econlib.org/library/Enc/Socialism.html

along China's coast, which then grew much faster than the rest of China. "I have two choices," said Deng. "I can distribute poverty or I can distribute wealth." He chose the latter.

Another convert was the head of the propaganda department of the Chinese Communist Party. After visiting Japan in the mid-1980s, he wrote a report on his visit. He noted that half of Japanese households owned a car and that over 95 percent of households owned TV sets, refrigerators, and washing machines. What also hit him over the head was the variety of clothing people wore: "One Sunday we went out to a busy street. Of all the women we saw, no two wore the same style of clothes." Then he added, "The female workers accompanying us also changed clothes every day."[17]

Or consider Manmohan Singh, an Indian socialist who had served as secretary of the South Commission, a commission peopled by believers in state intervention. Singh earned his undergraduate economics degree at Cambridge and his Ph.D. at Oxford[18] and made his living as a central planner. But in 1987, Mr. Singh took a little trip—to East Asia. This one trip led to an ever bigger intellectual journey. As Yergin and Stanislaw write, "He was stunned." Singh knew that as recently as 1960, India's per capita income rivaled South Korea's. But in just one generation, South Korea's per capita income had reached 10 times that of India. He noted two main factors behind this difference. First, whereas East Asian governments supported business, India's government heavily regulated them. Second, the East Asian countries had benefited from trade, in contrast to India's almost sealing off the border to trade.[19] Clearly, this is an example of a person who was convinced by seeing the results of (relative) freedom.

Singh went on to become finance minister under Prime Minister Rao and, together, with commerce minister P. Chidambaram, began to open the economy to trade and foreign investment and dismantle the "Permit Raj," India's system of heavy regulation. Within weeks, Rao's government cut subsidies for domestic products and for exports, reduced tariffs and trade barriers, eliminated licenses for 80 percent of industry, eliminated the requirement that large firms get permission to expand or diversify, and opened the economy to foreign investment. Invoking Mahatma Gandhi's vision of self-reliance, Singh stated, "Self-reliance means trade and not aid."[20]

Individuals and Ideas Matter

One common interpretation of history is that whatever happens is inevitable; that because great historic forces are at work, particular ideas and individuals don't matter for the outcome. This Marxist-like view is one that, interestingly, George Stigler embraced. In fact, his statement

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[17] *Commanding Heights*, p. 200, quoting from Joseph Fewsmith, *Dilemmas of Reform in China: Political Conflict and Economic Debate* (Armonk: M.E. Sharp, Inc., 1994), p. 37.
[18] *Commanding Heights*, pp. 220-221.
[19] *Commanding Heights*, p. 222.
[20] *Commanding Heights*, p. 225.

of that viewpoint was the main part of his 1978 presidential address to the Mont Pelerin Society in Hong Kong.

In that speech, Stigler argued that Mont Pelerin members who thought their ideas could change the world were mistaken because, he asserted, policymakers were already making judgments rationally and in their own self-interest. So, for example, there was no point in explaining to politicians that their tariffs on steel hurt consumers more than they helped the domestic steel industry. The policymakers already knew that and wanted to help producers at the expense of consumers. Therefore, there was nothing important that a believer in freedom could tell a politician.

After his Hong Kong speech, I asked Stigler if one could summarize his message with the statement that you can't tell people they are making mistakes because they already know everything they need to know. He said yes. Then why, I asked, did he bother giving the speech? Wasn't his goal to persuade the potential activists at the Mont Pelerin Society of something they didn't already believe?

What Stigler overlooked is that politicians, like the rest of us, have imperfect information. That he failed to note the import of this simple fact is shocking given his important role in getting economists to start thinking seriously about the economics of information. It's also shocking given his role in systematizing the economic analysis of regulation.

Politicians, like everyone else, have imperfect information about the world and, specifically, about the effects of various government policies. That's just a simple fact. Further, the kind of information they receive about the effects of government policies will be systematically biased in a particular direction.

As Stigler and others before him (Anthony Downs and Gordon Tullock, to name two) had pointed out, government policies tend to impose small per-capita costs on a large number of people in order to generate large per-capita benefits for a much smaller number of people. The beneficiaries from government policy, because they each benefit so much, will have a **loud** voice in emphasizing the benefits of the policies they favor. The losers from government policy, because each loses only a little, will have a very quiet voice in emphasizing the losses from government policy. So, for example, when the issue of import quotas on sugar is debated in Congress, the advocates of sugar quotas—who each gain thousands (and in a few cases, millions) of dollars annually from the quotas—will be very active in the debate, pointing out to wavering congressmen the gains in jobs created in the domestic sugar industry. The 300 million consumers of sugar, though, who lose an average of between $6 and $10 a year, will not even know about the debate. A politician who simply pays attention to what he hears, therefore, will tend to favor restricting imports, even though it can be shown that the cost to consumers exceeds the gains to domestic producers.

In his book, *The Culture of Spending*[21], James L. Payne reports that of a total of 1,060 people who testified before 14 House and Senate committees in selected years in the mid-1980s, 1,014 of them, or 95.7 percent, were in favor of the government programs. There were only seven opponents, or 0.7 percent of the overall number of witnesses. In other words, proponents outnumbered opponents 145 to 1.

Because politicians hear mainly from the beneficiaries of government policies, many of them can easily believe that most government policies produce net gains for society. You need to live in Washington or Ottawa or any capital city for only a short time to see how insulated politicians usually are from information about the negative consequences of their policies. Adding to that insulation is the fact that one important group of beneficiaries is the government bureaucracy. Payne found that of the 1,060 congressional witnesses mentioned above, 673 were government officials (497 of them being federal administrators), including 65 members of Congress. In other words, 63.5 percent of those testifying were government officials.

The combination of imperfect and biased information causes many politicians not to know—and possibly not even to suspect—that their policies cause widespread harm. Thus, what looks like a stable political equilibrium may in fact be an unstable equilibrium that could change with enough politicians acting on good information. Indeed, there are probably knife-edge equilibria that could be upset if just a few influential politicians change their ideas.

An observer and participant who knows far more than I of efforts to implement economic freedom in Latin America is UCLA's Arnold Harberger. He was one of the main economics professors at the University of Chicago who taught the "Chicago boys," the economists from Chile and other Latin American countries who returned home in the 1970s and 1980s and implemented various pro-freedom reforms.

In 1993, Harberger wrote of:

> [M]y long-standing conviction that successful economic policy in developing countries is very far from being the product of pure forces of history—something that happens when it happens because its time has come. Far from it, in every case about which I have close knowledge, the policy would in all probability have failed (or never got started) but for the efforts of a key group of individuals, and within that group, one or two outstanding leaders.[22]

In short, ideas matter and the individuals who hold them matter.

[21] James L. Payne, *The Culture of Spending*, ICS Press, 1991.

[22] Harberger, "Secrets of Success: A Handful of Heroes," *American Economic Review*, May 1993, Vol. 83, No. 2, pp. 343-350

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Henderson has also appeared on *The NewsHour with Jim Lehrer*, *The John Stossel Show*, *The O'Reilly Factor*, and networks including C-SPAN, CNN, MSNBC, RT, NPR, CBC, and BBC. Born and raised in Canada, he moved to the United States in 1972 to earn his PhD in economics at UCLA. He became a US citizen in April 1986.

Ideas of Freedom and Their Role in Active Policymaking

Condoleezza Rice

Good morning, and welcome to the Hoover Institution and to Stanford University. My colleagues have talked a great deal about the power of ideas in shaping an environment, as well as the power of the ideas of the 1980s that shaped the world as we now see it. I would like to focus on one particular idea that dramatically changed the landscape of the international order, and I would then like to talk a little bit about why we should not take for granted that such an international order will continue to obtain.

Ed Feulner and I were talking outside about my time in the government, when before George H. W. Bush went to meet Gorbachev in Malta, we invited a group of scholars, including Ed, to come up to Camp David and talk to the President, because George H. W. Bush had been bequeathed the effects of two great eras of ideas – the 1940s and the 1980s – and now it was time to harvest the benefits of what those ideas had produced. President Bush wanted to understand how we had gotten to where we were, and how we were going to deliver on the promise that American leaders had held in their minds since the end of World War II.

We have to recognize that, in fact, the first great set of ideas that would lead to the transformation of the world at the end of the 1980s really came about in the 1940s, from people like Paul Nitze and George Kennan, who believed that the way to counter a rising Soviet Union at the end of World War II was to deny the Soviet Union the course of external expansion until it had to turn to deal with its own internal contradictions. And American policy from the 1940s until the 1980s was essentially to deny the Soviet Union easy expansion, so that it would have to eventually turn to its own internal contradictions.

But by the end of the 1970s, people were not so certain that the Soviet Union was going to have to deal with those internal contradictions. In fact, in the 1970s, it looked like the Soviet Union, if anything, was on the rise. Anyone who visited the Soviet Union – and I first did so as a young graduate student in 1979 – knew that there was a tremendous disconnect between what one would see inside the Soviet Union and the tremendous power of the Soviet Union to shape international affairs. I remember one specific circumstance. I had gone into a store to buy an item, and the woman who was ringing up the price of my item was doing so on an abacus. And I remember thinking at that time, as a young specialist on the Soviet military, that there was a tremendous disconnect between doing math on an abacus and intercontinental ballistic missiles that could destroy the United States within a matter of moments.

But in fact, it turns out that the 1970s were simply covering a paradox about the Soviet Union which, in the early 1980s, Ronald Reagan would uncover. And that is that the Soviet Union was both capable of building those intercontinental ballistic missiles and maintaining an army of five million men stretched across Europe, and at the same time denying its own people the very basic goods of a developed society. And Reagan, drawing on ideas from people like Richard Pipes and our own Bob Conquest here at the Hoover Institution, recognized that it actually wasn’t a paradox at all. It was that the Soviet Union had made certain choices in order to maintain its international role and to dominate as an international player, and the choice had been to starve its people at home. And Reagan, more than any other leader, even Thatcher, recognized that this meant that the Soviet Union could be challenged, and if it were challenged, it might not be able to continue to make those tradeoffs.

And so the first part of the 1980s, with Ronald Reagan, was really about laying a foundation that would be harvested at the end of the 1980s. Again, as a young Soviet specialist here at Stanford, I remember thinking that Reagan's speech before the British parliament was rather undiplomatic. To say that the Soviet Union would end up on the "ash heap of history" did not sound like the language of a president of the United States to me. But in fact, this was precisely the formulation that those inside the Soviet Union, both its people and its leadership, knew was true. Indeed, it was a hapless experiment practiced on a hapless population that would end up on the ash heap of history.

Reagan would not just leave it to an idea. He would not just leave it to the word. He would actively seek policies that challenged the Soviet Union in a way that would no longer allow them to make the tradeoffs that they had been making: with increases in American defense spending. With a policy that said, *You will no longer have free rein in Afghanistan, because we will arm the mujahideen, and they will be able to shoot your planes out of the sky*. In Latin America, *You will no longer be able to arm those who wish to overthrow the order in Latin America; we will challenge you there*. And for Reagan, it was challenge and challenge and challenge.

Now, this produced, of course, in academic circles, the sense that Ronald Reagan was driving the United States down a road of conflict and confrontation with the Soviet Union from which we would never recover. Indeed, academia – most of academia – had accepted the idea that the international system was in some kind of equilibrium, with the United States and the Soviet Union sharing responsibility for a stable system based on mutually assured destruction of each other. In other words, you do it to me, I'll do it to you – that keeps us both stable. And so in many ways, the most revolutionary, subversive idea that Reagan would have was that not only should the Soviet Union be challenged, but that the nuclear order ought to be challenged. And that was really the power of the Strategic Defense Initiative.

Again, it was made fun of. *What do you mean you will stop nuclear missiles from coming in?* But actually, in the Soviet Union, they were seeing something quite different. They were not as concerned that their nuclear missiles could be knocked out of the sky. But the investment in the Strategic Defense Initiative – in sensors, in computing power, in the ability to get inside the decision cycle of another power – this they understood.

In the early 1980s, the then-Chief of the Soviet General Staff, Marshal Nikolai Ogarkov, acknowledged that the Soviets had fallen far behind militarily, a historical trajectory that General William Odom helpfully outlined in 1985: the first revolution in military affairs had been mechanization of forces. The second had been the nuclear age. But the third was in command, control, and intelligence. And there, Ogarkov said, the Americans are so far ahead that we have wasted our investment in our military forces. Now, when you're a Soviet leader and a huge portion of your GDP is going to military affairs, this is something of a shock.

They fired him.

But this then produced Mikhail Gorbachev, who decided that he had to have another way. And thus, the international context was set by the mid-1980s for a transformation of a system that people thought had been in equilibrium.

Now, it wasn't just what the United States did. It was also ideas that were growing up in places that were under Soviet occupation. When NATO realized that in places like Poland and Hungary, the Czech

Republic, what people had thought to have been failed revolutions in 1956, 1968, and 1980 had actually produced a kind of underground of people who continued to believe in the ideals of freedom, who continued to work toward those ideas of freedom – and they had help.

Poland is perhaps the best example of this. Solidarity, of course, was crushed by martial law in Poland in December 1981 until 1983. But it actually wasn't crushed. It went underground. And it was sustained by the oddest coalition that one could ever imagine: Ronald Reagan's CIA, Pope John Paul II's Vatican, and the AFL-CIO. Together, they made certain that Solidarity had the most basic of tools, like printing presses, to be able to continue to talk among themselves.

There was also in the 1970s something called the Conference on Security and Cooperation in Europe. It was actually hated, initially, by most conservatives. The Soviet Union would use it, people said, to reinforce the order that they had created. The Soviets had made one essential mistake. There was a Trojan horse inside the CSCE. They were excited that we had agreed to talk about security affairs. They were excited that we had agreed to talk about economic affairs. And the price they conceded was, *okay, you can have a human rights basket if you want; it's not going to matter*. Well, it turns out it mattered – because of all those conferences all over Eastern and Western Europe, where people in civil society in Eastern Europe would be protected to get out and talk among others. It turns out, that when the opening came at the end of the 1980s, they were ready.

This tells us, then, that ideas are critical and important. The ideas of people like Conquest and Pipes and indeed, Edward Teller, to say that the challenge to the international order would not result in war. It might, in fact, result in a more durable peace. The ideas of people like Havel and Wałęsa, who would say, *Freedom is not yet dead in our societies. Give us just a printing press, and we'll continue to get ready for that opening.* And those ideas would produce Mikhail Gorbachev, who figured out that he had to have a different way. There's a moment when Gorbachev and Eduard Shevardnadze are walking together after Gorbachev has been named General Secretary of the Communist Party. And Shevardnadze says to Gorbachev, "Comrade, you do know that everything is rotten, don't you?" And Gorbachev apparently never answers him. But Gorbachev knew that everything was rotten. At the same time that the idea in the West was that the Soviet Union was on the march, it turns out that those who knew that the Soviet Union was having to turn to deal with its own internal contradictions were right.

I was fortunate to be the young Soviet specialist from 1989 to 1991 for Brent Scowcroft and George H. W. Bush, who got to "harvest" those decisions. And I will tell you that to stand there and watch, in Poland, the liberation of Poland, where the Cold War started – the unification of Germany completely and totally on Western terms – and then the peaceful collapse of the Soviet Union – one recognized that something very dramatic had happened as a result of ideas and active policymaking on the basis of those ideas.

Now, that brings me to a remark I'd like to make about today. This should remind us that ideas sometimes take a while to actually come to fruition in policy, and that patience is important. I very often think about the patience that it took for the United States from the time that the Baltic states were incorporated into the Soviet Union until they were liberated, free states after the collapse of the Soviet Union – the patience that it took to stay the course. As a young Soviet specialist, I had a stamp on my desk. And whenever you mentioned Lithuania, Latvia, or Estonia, you had to stamp the document: "the United States does not recognize the forceful incorporation of the Baltic states into the Soviet Union."

We couldn't do anything about it. But we kept the ideal and the idea alive. And when the Baltic states would free themselves in 1991, they would become among America's best friends.

Sometimes it's a long road, and it takes time. And this is something that we should remember as we're watching in Eastern Europe, as there are challenges to the democracies that were built there in the 1990s, in places like Hungary and Poland. There are ups and downs in democratic development. We should remember this as we look to a Middle East where people are still too quick to say, *Those people really don't care about democracy.* Or to the demonstrators in Hong Kong who can't currently fix their circumstances but are saying loudly and clearly that they are not satisfied with their circumstances. It means that ideas matter, but so too does sticking with them.

Now I want to offer one final comment about something that Peter said which I think is absolutely true about where we are now. I'm very often asked, "Why do your students think that socialism is a good idea?" I asked my class last year, "How many of you were born before the Soviet Union collapsed?" None of them. "How many of you were born before 9/11?" A few of them, as four-year-olds, and six-year-olds, and seven-year-olds. It's very important to remember that it's easy to lose sight of what has been, and that's why it's important to continue to teach history. But it's also important for those of us who look to the past, and celebrate the past, to recognize that we may be facing new challenges to those ideas that we thought were settled in 1989 and 1990 and 1991.

Peter gave you a list of things that our students are seeing: social immobility, economic inequality, public schools that are failing, people who are opioid-addicted, people who have no skills for the modern era and are under the pressures of technology that is threatening to change the way that we live in dramatic fashion. It's not enough to say that it was done once before with ideas and action. There now have to be, I think, new responses from those who believe in free markets and free peoples to the challenges that we face. Late-stage capitalism is showing its age. People know it, but we don't really want to talk about it. We'd better talk about it, because there are those who never believed in it, who would challenge us to say, "Oh, well, that was just an interlude, that period of the 1980s." We know it wasn't an interlude. But if it's going to continue to be true, we are going to have to make it so.

Thank you very much.

CONDOLEEZZA RICE

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As a professor of political science, Rice has been on the Stanford faculty since 1981 and has won two of the highest teaching honors. Rice has authored and coauthored numerous books, including two best sellers, *No Higher Honor: A Memoir of My Years in Washington* (2011) and *Extraordinary, Ordinary People: A Memoir of Family* (2010). Born in Birmingham, Alabama, Rice earned her bachelor's degree in political science, cum laude and Phi Beta Kappa, from the University of Denver; her master's from the University of Notre Dame; and her PhD from the Graduate School of International Studies at the University of Denver.

"Lessons Learned from History for the Future of Freedom."

Assaults on Freedom and Citizenship

By Victor Davis Hanson

We often assume that most commonly democratic and republican governments erode by falling victim to right-wing authoritarians. Certainly, dictators, caudillos and renegade generals lust for power more than reflect ideological purity. The history of the 20th-century Mideast, Africa, and South America has often been one of military coups and juntas. But such take-overs are usually transparently over power and ensuring family dynasties that so often rarely last beyond a generation or two of strongmen.

In contrast, a more permanent and holistic destruction of freedom is the work of totalitarians promising utopian visions of equality and social justice, ambitious aims that require far more social, cultural, economic, and political coercion. Examine history's most successful tyrants of the ancient world, from the early 7th-and 6th-century BC Greek city-state, Alexander the Great, or Julius Caesar. Their opposition to and destruction of consensual government—and the justification for violence—was usually promulgated by claims of desiring universal brotherhood, or rectifying inequality, or the need to restructure the economy to ensure fairness for the downtrodden.

What frightened Europe about Napoleon was not just his lust for power and ideas of creating a French-dominated proto-European Union. In fact, his appeal was rarely couched in an admission of instituting an imperial Bonaparte dynasty run by his siblings, but rather was sold as a continuance of the French Revolution under its banner of liberty, equality and fraternity.

Benito Mussolini and Adolf Hitler sought power as opponents of market capitalism and big business and industry, promising a nationalist workers party and state sponsored socialism. The birth and record of Soviet communism and its spin-off and satellite expressions in Mao's China, the Kim dynasty of North Korea, Cuba of the Castro brothers, or the Peronists and Chavistas of South America reflect the same tired themes of leaders "of the people", dressed as common men, who supposedly sought power not to enhance their own wealth or family clans but as sacrifices on behalf of the underprivileged. Often, they posed as Caesarians who were bold enough to use military power to break up the oligarchies and aristocracies and thereby redistribute property to the masses.

If such dramatic authoritarian attempts at destroying freedom are easily recognizable, more common are more subtle and insidious efforts to erode personal freedoms, often by nominally democratic leaders who feel prior constitutional norms became simply too fossilized, insensitive, or obstructive to agendas of social justice.

Certainly, few observers foresaw that the six-nation European Common Market of 1957 would warp into a 28-member European Union of over 500 million people, with a vast permanent bureaucracy that sought to override national sovereignty and institute a pancontinental socialist agenda that often has proved anti-democratic and sharply curtailed personal freedoms.

Here in the United States, citizenship is steadily eroding at both the popular and elite levels—with the common theme of social justice as the catalyst. Residency is increasingly confused with citizenship. Social services make little distinction between legal citizens and illegal residents. And as the number of those residing illegally in the US rises, we are beginning to see calls for voting rights for non-citizens.

Three-centuries of American jurisprudence, custom, and tradition gradually had previously delineated important legal differences between citizenship and residence both legal and illegal. Among them were the rights to live inside the borders of the US indefinitely. And as a practical matter, since the 1920s only citizens were allowed to vote in local and national elections. During the 1950s the federal government required possession of a US passport to leave and enter the country at will.

Already two of those three pillars of citizenship have eroded. There are currently somewhere between 11 and 20 million illegal aliens residing in the US without legal sanction. Some have been given amnesties, and others de facto exemptions from deportation. The numbers are increasing, along with the custom and practice that legal citizenship or residence is not particularly necessary to live indefinitely inside the US, to obtain legal identification, to qualify for state and federal social services, or to crisscross US borders.

Aside from the fact that state motor-voter laws often are deliberately blurred or lax enough to allow ballot registration forms to be sent to illegal aliens who hold driver's licenses, non-citizens have also been given the rights in some jurisdictions to vote in municipal elections, a trend that is likewise accelerating. Illegal aliens legally can vote in local San Francisco school board elections, and a number of other cities have voted to follow suit. And the trend is growing. For purposes of the census, which governs the all-important redistricting of congressional seats, illegal aliens are counted and thus given as much electoral clout as citizens.

In other words, we are returning to 19^{th}-century practices when the westward expansion of the United States, coupled with commensurately small state populations, often meant that there were often no enforceable borders. On the relatively empty frontiers few cared to ascertain the legal status of residents. But whereas in the distant pass demography explained legal laxity, today politics do, or rather the doctrine of radical equality of result that seeks to erode any discriminating criteria concerning those residing in the US.

Tribalism is likewise an enemy of freedom and meritocracy. Much of American life seems to be retribalizing, as identity politics puts ever greater emphases on our superficial appearance and our self-identification with ethnical and racial solidarities rather than with common tradition and shared values. Salad-bowl multiculturalism has replaced melting-pot multiracialism. The reason why a Harvard Law School Professor Elizabeth Warren and University of Colorado professor Ward Churchill both invented Native American identities was to find the easiest and quickest way to enhance their respective career advancements. They correctly assumed that employers would favor, or be forced to favor, those who identified as a hyphenated American in general, and, in particular, someone of minority ancestry.

Over the last thirty years, but especially during the Obama years, the concept of affirmative action gradually gave way to the notion of "diversity". The former doctrine had originated as a means to "level the playfield" and give African-Americans an edge in college admissions and hiring on the theory that the toxic legacy of slavery and Jim Crow required such reparatory remedies.

More practically, diversity redefined the American body politic. Those who were now "diverse" encompassed almost anyone who claimed to be not "white", however that amorphous term was defined. Diverse now included wealthy Asians or Cubans, and a host of other groups heretofore not considered oppressed minorities. And the new diversity comprised nearly 30 percent of the population, with assumed historical complaints against the white majority—a new binary that sometimes requires resurrection of the "one-drop" rule of the Old South to maintain such a huge constituency. Those with one-quarter, one-eighth, or one-sixteenth non-white ancestry often apply as minorities for jobs, university admissions, and lucrative tribal council memberships.

Previous cultural differences in language, food, fashion, art, and music had enriched American life, but as subsidiaries to, rather than replacements of, the core of American citizenship and tradition and history. Instead, diversity now offered entire parallel and separate anti-Constitutional paradigms. Some students were housed on campus in racial theme houses. Others could select their potential roommates on the basis of race. "Safe spaces" were reserved for students on the basis of race. Proportional representation was applied to hiring and admissions, and disparate impact theories found insidious racism even without the supporting evidence of actual victims. An Asian-American citizen certainly had fewer constitutional rights of due process and non-discrimination when he applied to an Ivy League school than did a Latino-American or African-American.

If the foundations of citizenship are being recalibrated, so are its superstructures. Globalism may have started out with the spread of quasi-capitalism that introduced Western modes of production to the non-West and harmonized the globe through technological breakthroughs in transportation and communications, but is now to the point that almost anyone of the over 7-billion residents of the planet can call instantaneously any other at reasonable costs, communicate electronically, or within 24 hours travel between any two major cities.

But economic homogeneity and global connectiveness soon led to the utopian idea of commensurate political uniformity. And here was the problem: if America spearheaded the spread of global wealth creation, its unique constitutional system certainly did not become the model for political emulation. In Europe, the French Revolution, and the non-democratic autocracies and state bureaucracies that followed it, became more a blueprint for the European Union than the US Bill or Rights and Declaration of Independence. Poorer nations look to richer

Western systems that emphasize redistribution rather than equality of opportunity. Predictably, transnational institutions like the European Union, United Nations and its affiliated commissions, the Paris and Kyoto Climate Accords, and a host of others devoted to human rights, environmental protection, international commerce and trade, and health and welfare, became politicized, in the sense of insisting on share-the-wealth policies and redistributive justice contrary to the US Constitution.

But postmodern citizenship is also more than a matter of adopting global norms in preference to US customs and traditions, or using pressure groups to deny citizens their full protection of constitutional rights. There is currently a multitude of academic, legal, and political efforts to change either the US Constitution or the custom and practice of the federal government of the last century. The common denominator in all these progressive and media efforts, both informal and legal, is to curb individual liberty and freedom as the necessary price to ensure an equality of result among all residents.

When progressives become furious that the Trump Supreme Court errs on the side of the individual rather than the collective interest, they now seek to resurrect something akin to Franklin Delano Roosevelt's 1937 shameful effort to pack the court by increasing the membership beyond the current nine justices—or at least to intimidate sitting justices by threats of mandatory retirement. Many of the current Democratic presidential candidates have endorsed a new Supreme Court packing scheme. Similarly, we see the return of pre-Civil War state nullification of any federal laws deemed oppressive or obstructive. Currently over 500 "sanctuary city" local and state jurisdictions have announced that they will not fully comply with federal immigration law, in ironic fashion adopting the failed strategies of southern obstructionists of Civil Rights legislation of the 1960s.

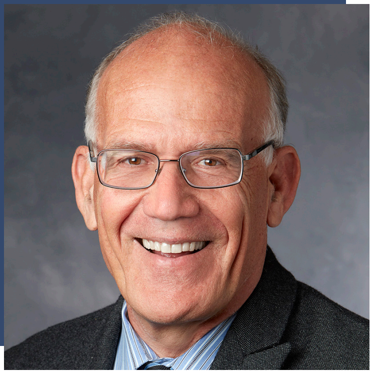
Given that George W. Bush and Donald Trump both won elections without a majority of the popular vote, current reformers also seek either to disband the Electoral College or pass state laws requiring a state to pledge its electors to the winner of the popular vote rather than to reflect the will of the majority of voters within a state.

There have even been calls to recalibrate the US Senate to address supposedly unfairness such as the distribution of senators by state. For example, two conservative senators in Wyoming each roughly represent a quarter-million voters, while their two liberal counter parts in California each speak for 20 million. In answer, many progressives have advocated turning the US Senate into something analogous to the House of Representatives where congressional offices reflect national demography.

The list of proposed changes to both the Constitution and long legislative custom and practice that have been ratified and upheld by the courts is nearly endless. Again, the effort is fundamentally to transform and recalibrate an American constitutional republic to resemble a Jacobin sort of democracy, in which what a majority of residents on any given day prefers becomes law.

The result is that the United States is becoming a country of pre- and post-citizens—of residents on the one hand who are not citizens by either legal definition or outlook, and of elites who feel national boundaries are bothersome, that the Constitution is ossified and that there are government remedies to inequality that should trump constitutionally protected liberties.

Our constitutional freedoms will likely not fall abruptly to identifiable right-wing plotters in *Seven Days in May* fashion, but more likely in insidious fashion to professed egalitarians, who claim they need far more power and latitude to save the planet, end inequality, and make us a more fair and just people.



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Fed Chair Agonistes
Amity Shlaes

A sure bet in 2020 is that President Donald Trump will bully Fed Chairman Jerome Powell, pressuring Chairman Powell and the Open Market Committee to set interest rates lower than Fed wants them. Chairman Powell wants them. In fact, the only dispute is how brash President Trump will be. After all, the President already got out a few zingers last year. "China is not our problem, the Federal Reserve is," President Donald Trump said after Mr. Powell led his board in lowering interest rates 25 basis points, a smaller increment than the President desired. Last summer the President suggested that Mr. Powell's interest rates were so high that they were preventing the economy from zooming forward "like a rocket ship."

Such audacity feels uniquely Trumpian. It isn't. Though our modern political culture holds that the Federal Reserve is independent, other postwar Presidents have bullied Fed chairmen, whether directly or through loyal proxies. The names of the bullies include Lyndon Johnson and Ronald Reagan. At this event, we are mourning Paul Volcker, the Fed chairman with the greatest fortitude. Volcker didn't complain loudly about Reagan at the time. But he wrote a memoir before he passed away. In that memoir Volcker details the level of the pressure placed upon him. In the summer of 1984 Treasury Secretary James Baker summoned Volcker to the White House. "The president is ordering you not to raise interest rates before the election," Baker told Volcker. The worst example of Fed bullying however is President Richard Nixon's successful campaign to coerce "his" Fed chairman, Arthur

Burns, into leading the Fed in policy that guaranteed devastating inflation.

The story of Burns at the Fed is worth reviewing, because it provides us with a reminder of how politics and personality prevail over character and trade. For if anyone seemed likely to withstand the pressure from Richard Nixon, it was Arthur Frank Burns. In the 1950s, when Nixon was a young vice president, the older Burns chaired the Council of Economic Advisors, winning the admiration of young politicians, including Nixon, for his professionalism. In 1960, when Nixon ran for president the first time, it was the pipe-puffing Arthur from whom Nixon took counsel. Burns warned Nixon that unless Congress and the Fed moved taxes and interest rates down substantially, voters would turn away from the Republican Party and elect John F. Kennedy. The taxes and interest rates did not come down dramatically, and Nixon did lose. But Burns had supplied Nixon with that gift most precious to politicians: a plausible explanation of why the politician's defeat was not the politician's fault. The grateful Nixon never forgot, and in turn gave Burns a gift just as precious, at least to a proud professional: Nixon listened to him. Burns was sure Nixon liked him, and wrote in his diary at one point that he considered himself Nixon's "best friend."

Outsiders placed confidence in Burns for another reason: the high respect paid him by the guild of professional economists. Early on, Burns had won has his peers' approval as a star data cruncher and wizard forecaster. It was said that Burns predicted the strength of the 1955 recovery by the thickness of the cigarette smoke in the General Motors salesrooms. Burns' work on inflation was hawkish, and included a monograph, "Prosperity Without Inflation." He appeared admirably independent, contradicting colleagues with an early and genuinely prophetic determination that corruption in the Soviet regime would kill the Russian economy. Nixon's decision to bring Burns into his administration in 1969 was regarded as a sign of the integrity of both men. People commented that men like Burns with his retro, center-parted, hair and pipe seemed like grownups, a welcome shift from the whiz-kid hires of Johnson and Kennedy.

But after Nixon moved Burns Burns over to the Fed in 1970, Burns found his friend suddenly cooler. Nixon wanted lower interest rates. After a time Burns and his board did lower rates, but as Mr. Powell and colleagues today, the Burns Fed moved in modest increments of 25 basis points. Burns believed he could convince Nixon of the merit of gradualism if he could get the president's ear. Yet this time he could not. Instead Nixon dispatched emissaries such as John Ehrlichman to deliver threats: "The president will take on the Fed publicly if its Open Market Committee retaliates." Or: "responsibility for a recession is directly on the Fed."

By early 1971 Nixon was introducing yet another blocker, this time the new Treasury Secretary, John Connally. Connally was a Democrat, an unorthodox choice for a president, but the real sin in the nomination from Burns' point of view was that Connally was no economist, not even a banker, just, as Burns put it, "a most smooth politician." The offense of the Connally hire was compounded when Connally took a crash course in monetary theory not from Burns but from his predecessor, William McChesney Martin. Connally ordered all White House hands to follow White House policy—and included Burns as a "hand."

Far from making an exception of Burns, the now hardening Nixon simply watched the torture of Burns with amusement. Bullies look for vulnerability. Burns' vulnerability, Nixon thought, was his Jewish background. "You know I think Connally is anti-Semitic," Nixon rambled to Ehrlichman. "It probably troubles him to deal with Herbert Stein and Arthur Burns and Henry Kissinger and [speechwriter William] Safire. Too bad." "The government is full of Jews," Nixon told another aide, H.R. Haldeman. There was "a Jewish cabal" in government. "And they all only talk to Jews." In Burns' case, this was hardly so. The person Burns *wanted* to talk to was Nixon.

As the year 1971 progressed, economic news did not improve sufficiently to please the White House, and Nixon and his men continued to give Burns the treatment. Burns goosed the money supply, irritating Milton Friedman, but not enough to please the insatiable Nixon. Later, Ehrlichman would record the standard scolding he was sent to deliver: "The President made you chairman of the Fed, Arthur," Ehrlichman would say. "You are deeply in his debt. He expects you to be loyal." No move was too petty for Nixon. In those days White House Sunday church services provided a chance for presidential access. Nixon's staff moved to block Burns' attendance: "keep him off Church," read one memo.

By June of 1971 the consumer price index was increasing at an annualized 6% rate, and Burns was desperate. Though a free marketeer, Burns wanted the approbration of his peers. Let someone else – anybody else – deal with the inflation problem. Burns therefore told Nixon that inflation, or its appearance, would abate for a time if Nixon and Congress placed some government restraints on wages and prices. If they didn't, Burns would have to raise interest rates and further irritate his chief executive. Come

July, Burns finally and momentarily heeded conscience and colleagues and led the Fed in raising the discount rate 25 basis points. The President retaliated by allowing his aides to sneak a smear story—adumbration of Watergate!-- in *The Wall Street Journal*. The story included a leak suggesting that Burns was demanding that his own salary be raised 50%. This was false. The story also announced that the "furious" president was considering legislation that would "specifically would bring the Federal Reserve into the executive branch." Burns saw, as he wrote in his diary, that "I would be accepted in the future only if I suppressed my will…" Here Burns had a choice. He could do what the economy needed, or he could, as he put it, "suppress his will." Burns suppressed his will.

What came next, over the summer of 1971, demonstrated the extent of that suppression. For Nixon had indeed absorbed the 1960 lesson, perhaps better than Burns liked. His eye now firmly on the 1972 election, the president mooted a preposterously incoherent stimulus plan: tariffs, a wage-and-price freeze, targeted tax cuts, and closing the gold window, the last vestige of the gold standard. Burns might have lived with individual components, but taken together the plan was professional anathema. Yet when Nixon invited Burns to join the economic team for a Camp David retreat to formalize the plan, Burns was so relieved to be included that after a pro-forma protest against one move – the gold standard suspension – the Fed chairman simply went along. The president, Burns told speechwriter William Safire, had his "wholehearted support."

What followed, too many Americans still remember. For Burns, a momentary elation: the Fed chairman was back in his president's good graces. For Nixon, a political victory – the measures masked the inflation and goosed growth that reelected Nixon in 1972. But great lows followed these short-term highs. Nixon's imperiousness cost him the presidency. It cost the U.S. its economy. A storm of inflation followed when the price controls ended. The 4.5%, 5% or 6% interest rates that Burns in his denial told himself were high enough proved nowhere near the level needed to stop the inflation, which within a few years would surpass 10%. The tragedy was practically Grecian: Burns, the prophet who had spent a career warning of inflation, had promulgated policy that caused it.

The Nixon-Burns story is a saga of personal vanity and human ambition. But it also reflects a political cycle common to nations the world over. Voters reward politicians who give them good times. Presidents want Congress to supply those good times, by voting into laws tax cuts or new entitlement programs. But sometimes – in Nixon's era – Congress doesn't want to cooperate. After all, spending more now makes it even harder for the government to meet long-term commitments – Social Security payments, Medicare – later. So Presidents in their frustration turn to the Fed, knowing that dumping money into the economy will supply those good times – short term, before the inflation kicks in. Since Burns' day, a change in our monetary laws has made it even easier for the Fed chairman to succumb to president's demands that they help the general economy. The Humphrey-Hawkins Act made the Fed's responsibility for the entire economy more explicit by requiring that the Fed pursue, along with the goals of stable money and low interest rates, maximum employment.

What can a meeting of MPS make of all this? We cannot change human nature. Paul Volcker, the Fed chairman who made the right choice, is mourned almost to the point of deification by both citizens who support both political parties. But Volcker was that exceptional benign dictator familiar from history books. What stories like that of Johnson, Nixon and Burns generally show is that leadership at the Fed cannot be conducted with true integrity without more rules governing Fed operation – the kind John Taylor has advocated – so that the Fed does not operate ad hoc. New statute is necessary to remove the employment and growth component of Fed policy. The Burns of 1970 thought he was in charge of the whole economy, a kind of vainglory. But the general assumption then was that the Fed was responsible, and that reinforced the arrogance of an otherwise thoughtful man.

Limiting inflation's likelihood in the future would be easier if the Fed's assignment were more modest: not rocketship captain, but perhaps engineer, assigned to watch meters and monitor money. As a young scholar wrote six decades ago, "all that may be reasonably expected of the federal reserve system is that it will do everything, within its limited powers, to keep the price level from rising further." That scholar's name was Arthur Burns.

AMITY SHLAES

CALVIN COOLIDGE PRESIDENTIAL FOUNDATION

Amity Shlaes chairs the board of the Calvin Coolidge Presidential Foundation, based in Plymouth Notch, Vermont, the birthplace of the thirtieth US president, with an office in the Georgetown area of Washington, DC. The Coolidge Foundation is the sponsor of the popular Coolidge Scholarship, a full college scholarship for academic merit, and the Coolidge Senators program, which exposes gifted students to the values of President Coolidge.

Her newest book is *The Great Society: A New History* (November 2019, Harper Collins). Shlaes is the author of five previous books, four of which are *New York Times* bestsellers: *Germany: The Empire Within*; *The Greedy Hand: Why Taxes Drive Americans Crazy*; *The Forgotten Man: A New History of the Great Depression*; *Coolidge*; and *The Forgotten Man Graphic Edition*. She was a syndicated columnist for ten years, first at the *Financial Times*, then *Bloomberg*.

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Keynes v Hayek: The Four Buts....

MPS, 16 January 2020

Robert Skidelsky

You all know about Hayek's *Road to Serfdom*, his great anti-central planning polemic of 1944, which inspired the foundation of the Mont Pelerin Society. Perhaps less familiar is the letter Keynes wrote Hayek on reading the book. 'In my opinion it is a grand book...morally and philosophically I find myself in agreement with virtually the whole of it; and not only in agreement with it, but in a deeply moved agreement'.[i] Surely, this effusive endorsement -a publisher's dream blurb - would have qualified Keynes for membership of the Mount Pelerin Society? But Keynes, as always, chose his words carefully. Moral and philosophical agreement by no means implied political agreement. Keynes's letter contained four important 'Buts…' My talk today is about those BUTs, which are as worth discussing today as they were in 1944.

The First 'But…'

'What we need, therefore', Keynes wrote to Hayek, 'is not a change in our economic programmes, which would only lead in practice to disillusion with the results of your philosophy, but perhaps even....an enlargement of them'. Here Keynes raises the crucial question of the nature of the inoculation needed against the collectivist virus. Keynes wanted to inject a limited amount of what they both called 'planning' into the economy to protect the patient from its virulent form. Hayek claimed that Keynes's vaccine was bound to bring on the full blown disease. Keynes, in turn thought that Hayek's intransigent resistance to any encroachment on market allocation was likely to bring on the very evils it claimed to prevent. This was the nub of the issue between them.

Hayek, as is well known, wanted to allow slumps to run their course. In his view they were caused by excessive credit, leading to a distorted structure of production, which was bound to collapse when the economy ran out of saving to complete the investments. To inject more credit into a diseased system would only make the disease worse. The malinvestments had to be liquidated for healthy growth to resume.[ii] Although Nazi Germany was, together with Soviet Communism, the epitome of the serfdom against which Hayek warned, his classic book never mentioned the Great Depression But Keynes's policy proposals were framed by it. And in my view rightly so. The figures speak for themselves.

In 1928, the National Socialist Party won just 2.6% of the votes in the elections for the Reichstag. Lord D'Abernon, British Ambassador to Germany in the 1920s, wrote in his diary in 1928 that 'Hitler has faded into oblivion'.[iii] In 1930, the Nazis got 18% of the vote, and in 1932 37%..Since the Depression was never central to Hayek's account of the success of fascism, he failed to give any credit to FDR's New Deal in preventing the the growth of fascism in the USA.. In his view,Hitler and Roosevelt were cut from the same collectivist cloth, which led an American reviewer of Hayek's book to point out acidly that 'the preparation for an electrocution and for an electrocardiograph is the same, up to a point'.[iv]

Inflaion was always the danger against which Hayek warned, never unemployment, which was derivative of a prior inflation.

This issue is far from dead today. Were western governments right to bail out their banking systems in 2008-9? Were the vast stimulus packages led by the USA and China the right response to that crisis -or should they all have swallowed the Hayekian medicine and let the insolvent banking system fail? . This, of course, is as much a political as an economic question.

Then there is the question of prevention. Hayek believed economies were naturally stable in the absence of monetary distortion. Keynes thought they were naturally unstable, and needed to be stabilised by policy.I don't believe economics is any closer to resolving this question.

The Second 'But....

'You admit...that it is a question of knowing where to draw the line. You agree that the line has to be drawn somewhere, and that the logical extreme is not possible. But you give us no guidance whatever as to where to draw it....I should guess that according to my ideas you greatly under-estimate the practicability of the middle course. But as soon as you admit that the extreme is not possible...you are, on your own argument done for, since you are trying to persuade us that so soon as one moves an inch in the planned direction you are necessarily launched on the slippery path which will lead you in due course over the precipice'.

The point Keynes was making was surely correct: that Hayek's defence of liberty was pragmatic, not principled. This criticism hits home for many libertarians who deplored Hayek's concessions to what they would call socialism (Ayn Rand denounced him as a 'compromiser') According to Anthony de Jasay, Hayek's social order has no clear line: 'it permits, if not positively mandates, the state to produce any number [of public goods] in any quantity; the state's place in society is consequently *ad hoc,* open-ended, indeterminate, and no amount of dire warnings against socialism, fatal conceit, and loss of freedom will make it more determinate'. [v]

According to Hayek, government in all its actions must be bound by rules 'fixed and announced beforehand'. The rule of law had to maintain procedural, not substantive, justice; formal, not substantive equality. The difference was between laying down the rule of the road as in a highway code, and ordering people where to go. Thus the rules should be quite general, and not be not be aimed directly at benefitting or harming specific groups or bringing about particular situations. This justified coercive anti-monopoly legislation; it ruled out racial discrimination.

In chapter 9 Hayek implicitly acknowledges that the capitalist system fails to provide sufficient social security, and devotes several pages to the need for minimum security provision 'outside the market'.[vi]

Although Hayek's commitment to freedom cannot be doubted, his critics were right to point out that he offered no principled defence of individual liberty.His general rules offered no assurance against extreme coercion provided all were coerced equally, for example, his endorsement of conscription, as against Keynes, who took a principled stand against conscription in the name of individual liberty.[vii]

Libertarian critics of Hayek were right, therefore, to argue that Hayek offered no principled defence against state encroachment on individual liberty, only a contingent defence based on the knowledge limitations of the central planner. The big give away is the passage in the *Constitution of Liberty* (1960), when Hayek said that if men were omniscient 'there would be little case for liberty'.[viii] Keynes's rights-based philosophy offers a stronger protection of liberty than Hayek's quasi- utilitarian defence.

The Third 'But…'

‘Dangerous acts can be done safely in a community which thinks and feels rightly, which would be the way to hell if they were executed by those who think and feel wrongly’ .

What Keynes is saying here is that moderate planning of the type he was advocating need not lead to serfdom in a country with a liberal tradition; American critics of Hayek made exactly this point, pointing to the different political traditions of Britain and the United States and Russia and Germany.

Keynes’s argument is is not as convincing as it seems at first sight. It was clearly safer to have Churchill running the war than Hitler, even though the wartime organisation of Britain and Germany was similar. But this was a static argument. It assumed that the evolved political language of the community was proof against coercive state interventions. But the language is affected by the intervention, and the appetite grows with the feeding. . A society in which ‘dangerous acts’ by governments become continuous will lose its understanding of why they are dangerous –that is, its sense of what it is to be free. And this has happened to some extent. To give just one example: today we accept levels of state surveillance which would have been unthinkable even twenty or thirty years ago, comforting ourselves with the thought that the surveillers are men and women of goodwill. This is a pretty ominous slippery slope, and Hayek was right to warn against it.[ix]

The Fourth ‘But….’

‘ No, what we need is the restoration of right moral thinking -a return to proper moral values in our social philosophy. If only you could turn your crusade in that direction you would not look or feel quite so much like Don Quixote. I accuse you of perhaps confusing a little bit the moral and the material issues’.

This cryptic passage needs some unpicking. Keynes’s criticism is that Hayek was too willing to sacrifice ‘moral values’ to those of economic efficiency. The contrast he wanted to draw was between the ‘scarcity’ and the ‘abundance’ perspectives.

For Hayek, scarcity was the condition of freedom, for it required the exercise of choice. This was the classic perspective of economics, enshrined in Robbins’ definition of economics as the science which studies human behaviour ‘as a relationship between ends and scarce **means** which have alternative uses." Hayek in turn writes ‘Freedom to order our own conduct in the sphere where material circumstances force a choice upon us, and responsibility for the arrangement of our own life according to our own conscience, is the air in which alone moral sense grows and in which moral values are daily re-created in the free decisions of the individual'. Here is surely a case of confusing 'more than a bit' economic choice with moral choice. Hayek believed that the moral sense grows out of material necessity, and that in promising to abolish poverty -and thus the economic problem - the collectivists were extinguishing moral choice. 'A movement whose main promise is the relief from responsibility cannot but be anti-moral in its effect', he wrote.[x] The reassertion of the primacy of scarcity, and frequent attacks on the 'false promise' of 'potential abundance' thus seem foundational to Hayek's concept of morality.[xi]

This was quite contrary to Keynes. Keynes had argued, in his essay *Economic Possibilities for our Grandchildren*, published in 1930, that the potential plenty made possible by technology would reduce the importance of the value of economic efficiency , enabling people, for the first time in history, to live 'wisely, agreeably, and well'. In other words, the conquest of poverty would, for the first time, enable humanity to quit the realm of necessity and enter the realm of freedom.

Despite the fact that Hayek had taken another side-swipe at Keynes, Keynes's letter was impeccably courteous. Hayek would appear less of a Don Quixote, he wrote, had he coupled his attack on central planning with the argument that we would not need it, because the economic problem which it claimed to solve, would have been solved by capitalism anyway.

Conclusion

Hayek thought of Keynes a great man, but not a great economist. Keynes thought *The Road to Serfdom* a 'grand book', but little of Hayek's economics. How might they have continued the argument had Keynes not died in 1946.

The debate about the validity of their economics remains open. It hinges on the question of the extent to which full employment is the normal or strong tendency of a decentralised system. Hayek thought it was; Keynes thought it wasn't. Both could appeal to the facts to support them. Hayek could point out that the capitalist market economy had been the major factor in lifting the world out of poverty and reducing violence, Keynes to the fact that it achieved full employment only in 'moments of excitement' ; that its progress was punctuated by crashes which periodically threw millions out of work; and that the capitalist era had witnessed two of the most devastating wars in history.

The two men might have continued to debate about whether the malfunctions of the market system were the result of external interference, as Hayek supposed, or inherent, with certain kinds of interference being needed to correct them, as Keynes claimed. Such arguments would have continued to turn on the amount of knowledge or information available to economic actors. Both agreed on the importance of ignorance in human affairs. But whereas Hayek contrasted the ignorance of the central panner with the dispersed knowledge of individual market transactors, Keynes stressed the ignorance arising from uncertainty. Thus whereas Hayek thought of economic intervention as destroying knowledge available in markets, Keynes thought of it as reducing the uncertainty which made markets unstable.

But in the nature of the case, this disagreement could not have been settled by the facts, because economies work under different institutional conditions, different conditions of knowledge, and one is never properly able to compare like with like. Keynes would have pointed to the economic success which marked his twenty-five epoch of moderate planning, and the renewed instability which accompanied its rejection after 1980. Hayek would have countered with the inflationary crisis which ultimately engulfed the Keynesian revolution and the 'Great Moderation' of the 1990s and early 2000s. What would they have made of the crash of 2008-9, quantitative easing, and the current move back to fiscal policy?

The question where to draw the line is still very much alive. Keynes was in favour of limited intervention to secure full employment. But Keynesianism mutated into Keynesian social democracy in the 1960s, with state spending creeping up to 40-50 per cent of national income. For Hayek red lights would have flashed: here, he would have told Keynes, was the slippery slope. Neither man's philosophy told you where it as safe to draw the line. This is something we must work out anew.

The debate on the morality of capitalism is still far from over. Keynes himself admitted that the poverty problem still plagued most of the world, so he might have conceded that Hayek's scarcity perspective could not be entirely jettisoned. But how would Hayek have reacted to the fact that it is capitalism's rampant consumerism , not collectivism, that has been weakening the moral values for which he stood? And how would Keynes have responded to the re-emergence of scarcity in rich countries in the form of climate change and potential exhaustion of natural resources? The two old fogies might have found more common ground in deploring the decay of capitalist civilisation than they managed in 1944.

A broader ground for debate would have concerned the legitimacy of the capitalist market order, its ability to maintain consent. The argument seemed to have been settled in favour of Keynesian social democracy; it then veered back towards a Hayekian view; now, with the populist assault on the liberal values of free markets and the rule of law, the question is open again, with Hayek's indifference to unemployment and social inequality exposed as major political weaknesses of the post-Keynesian order.

In the end, you can't prove either Hayek or Keynes to have been right. Social democracy did not collapse into serfdom. But Hayek guarded himself against this. He wrote that 'the democratic statesman who sets out to plan economic life will soon be confronted with the alternative of either assuming dictatorial powers or abandoning his plans'. By the 1970s there was some evidence of the slippery slope...and then there came Reagan and Thatcher. Hayek's warning played a critical part in Thatcher's determination to 'roll back the state'. Equally, though, Keynes had earlier given liberalism an economic agenda to fight back against socialism and communism, by demonstrating that societies didn't need 'serfdom' to secure full employment.

Both were lovers and defenders of freedom. In 1944, Keynes had the grace to acknowledge Hayek's role in its defence, while Hayek, with fifty years for further reflection, never had the generosity of spirit to acknowledge Keynes's. (2867)

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[i] Keynes to Hayek, 28 June 1944. Reproduced in vol. 27 of The Collected Writings of John Maynard Keynes, pp.385-8. Keynes had read *The Road to Serfdom crossing the Atkantic on his way to the Bretton Woods Conference.*

[ii] I haver seen no convincing evidence that Hayek ever retracted this view. In his memoirs*, Autobiography of an Economist ,* 1971,Lionel Robbins wrote (p.154) that Hayek's remedy of letting depressions run their course was 'as unsuitable as denying blankets and stimulants to a drunk who has fallen into an icy pond, on the ground that his original tropuble was overheating. In his *The GeneraL Theory of Employment, Interest and Money*, 1936,p.20n, Keynes paid a backhanded compliment to Lionel Robbins, then the British cheer-leader of the Austrian school, that he ' almost alone, continues to maintain a consistent scheme of thought, his practical recommendations belonging to the same system as his theory'.

[iii] Lord D'Abernon, *An Ambassdor of Peace, 1929-30*, ii,pp.51-2n.

[iv] T.V.Smith, *Ethics*, vol.55,no.3,April 1945, pp.224-6

[v] Anthony de Jasay, 'Hayek: Some Missing Pieces', *Review of Austrian Economics, vol.9, no.1.1996,* p.113. Jasay argues that Hayek's views on state intervention were diminated by his aim of making the market system politically attractive.

[vi] F.A.Hayek, *The Road to Serfdom,* 1962 paperback ed), p.99. All quotations are from this edition.

[vii] Of the attitude of the two men towards conscription, see Hayek, *The Constitution of Liberty,* 1960, p.153, where he writes that conscription , by being enforced on all is largely deprived of the 'evil nature of coercion', and Keynes who a 'conscientious objection' to surrendering 'my liberty of judgment on so vital a question as undertaking military service'. (q.Robert Skidelsky*, John Maynard Keynes: Hopes Betrayed 1883-1920*, 1983, pp.315-6.

[viii] Hayek, *Constitution of Liberty,*p.29

[ix] Eg.,Hayek,*Road to Serfdom,*p.101, and ch.xi. *passim*

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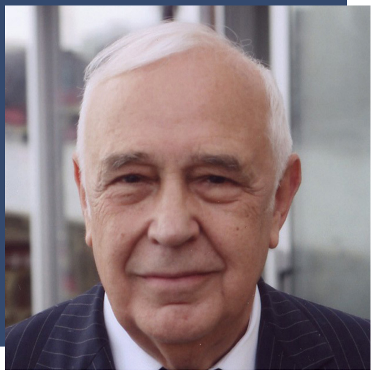
[xi] For Hayek's attacks on the doctrine of 'poitential abundance' see ibid., pp.19,78,15.,



ROBERT SKIDELSKY

HISTORIAN

Robert Skidelsky is a British historian and economist best known for his award-winning three-volume biography on John Maynard Keynes. The second volume, *The Economist as Saviour, 1920–1937*, won the Wolfson History Prize in 1992. The third volume, *Fighting for Britain, 1937–1946*, won the Duff Cooper Prize in 2000, the James Tait Black Memorial Prize for biography in 2001, the Arthur Ross Book Award for international relations in 2002, and the Lionel Gelber Prize for International Relations, and was short-listed for the Samuel Johnson Prize for nonfiction writing in 2001. Other writings include *Keynes: The Return of the Master*. Skidelsky has also written many relevant papers and books on the British economy.

Capitalism, Socialism and Nationalism: Lessons from History

Niall Ferguson

I

Joseph Schumpeter was pessimistic. 'Can capitalism survive?' he asked in his book *Capitalism, Socialism and Democracy* (1942). His answer was stark: 'No. I do not think it can.' He then posed and answered a second question: 'Can socialism work? Of course it can.'[1]

Perhaps the Austrian-born economist's pessimism was simply the effect of teaching at Harvard. (By temperament a conservative who was hostile to the New Deal and allergic to Keynesianism, Schumpeter gradually tired of the 'cocoon' on the banks of the Charles, and came very close to moving to Yale on the eve of World War II.)[2] Yet Schumpeter offered four plausible reasons for believing that socialism's prospects would be brighter than capitalism's in the second half of the twentieth century, even if he signaled his strong preference for capitalism in his ironical discussion of socialism.

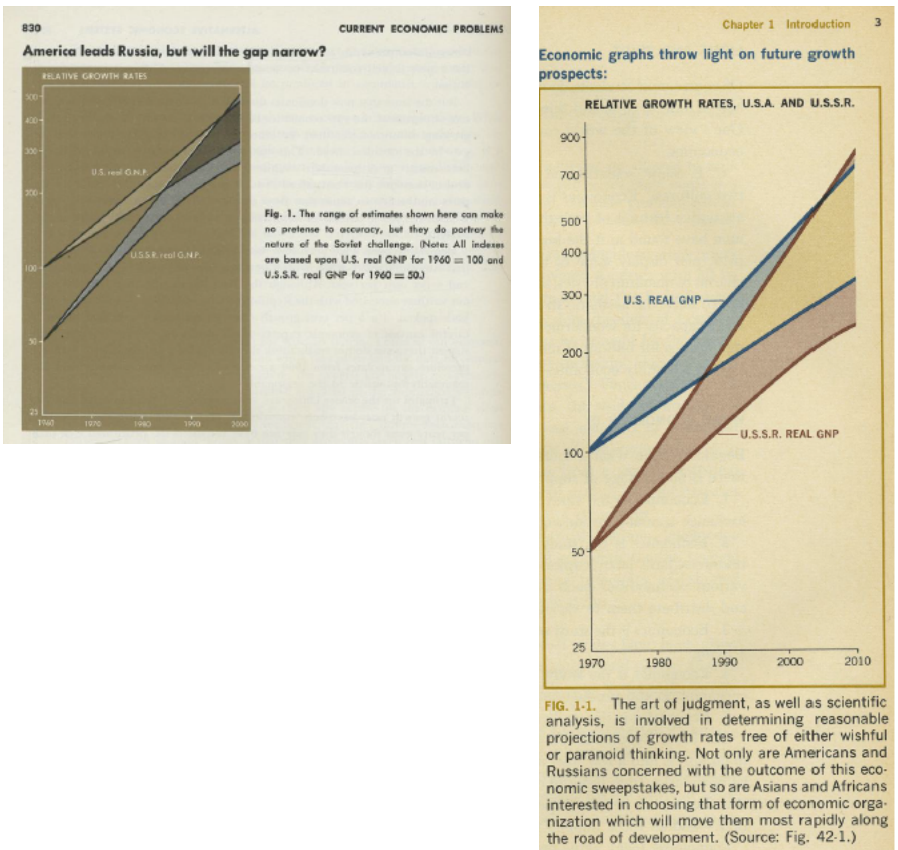
First, he suggested, capitalism's greatest strength—its propensity for 'creative destruction'—is also a source of weakness. Disruption may be the process that clears out the obsolescent and fosters the advent of the new, but precisely for that reason it can never be universally loved. Second, capitalism itself tends towards oligopoly, not perfect competition. The more concentrated economic power becomes, the harder it is to legitimize the system, especially in America, where 'big business' tends to get confused with 'monopoly.' Third, capitalism 'creates, educates and subsidizes a vested interest in social unrest'—namely, intellectuals. (Here was the influence of Harvard; Schumpeter knew whereof he spoke.) Finally, Schumpeter noted, socialism is politically irresistible to bureaucrats and democratic politicians.[3]

The idea that socialism would ultimately prevail over capitalism was quite a widespread view—especially in Cambridge, Massachusetts. It persisted throughout the Cold War. 'The Soviet economy is proof that, contrary to what many skeptics had earlier believed, a socialist command economy can function and even thrive,' wrote Paul Samuelson, Schumpeter's pupil, in the 1961 edition of his economics textbook—a sentence that still appeared in the 1989 edition. In successive editions, Samuelson's hugely influential book carried a chart projecting that the gross national product of the Soviet Union would exceed that of the United States at some point between 1984 and 1997 (see figure 1). The 1967 edition suggested that the great overtaking could happen as early as 1977. By the 1980 edition, the timeframe for this great overtaking had been moved forward to 2002-2012. The graph was quietly dropped after the 1980 edition.[4]

Samuelson was by no means the only American scholar to make this mistake. Other economists in the 1960s and 1970s—notably Campbell McConnell and George Bach—were 'so over-confident about Soviet economic growth that evidence of model failure was repeatedly blamed on events outside the model's control,' such as 'bad weather.' Curiously, McConnell's textbook more or less consistently estimated U.S. GNP to be double that of the USSR between its 1960 and its 1990 editions, despite also insisting in the same period that the Soviet economy had a growth rate roughly double the American.[5] Yet it was Lorie Tarshis whose textbook drew the most damaging fire (from William F. Buckley amongst others) for its sympathetic treatment of economic planning, despite the fact that Tarshis was more realistic in his assessment of Soviet growth.[6] The uncritical use of the simplistic 'production possibility frontier' framework—in which all economies essentially make a choice between guns and butter—was a key reason for the tendency to overrate Soviet performance.[7] For example, as late as 1984 John Kenneth Galbraith could still insist that 'the Russian system succeeds because, in contrast with the

Western industrial economies, it makes full use of its manpower.' Economists who discerned the miserable realities of the planned economy, such as G. Warren Nutter of the University of Virginia, were few and far between—almost as rare as historians, such as Robert Conquest, who grasped the enormity of the Soviet system's crimes against its own citizens.[8]

Figure 1. Paul Samuelson's projections of U.S. and USSR GNP, 1967 and 1970



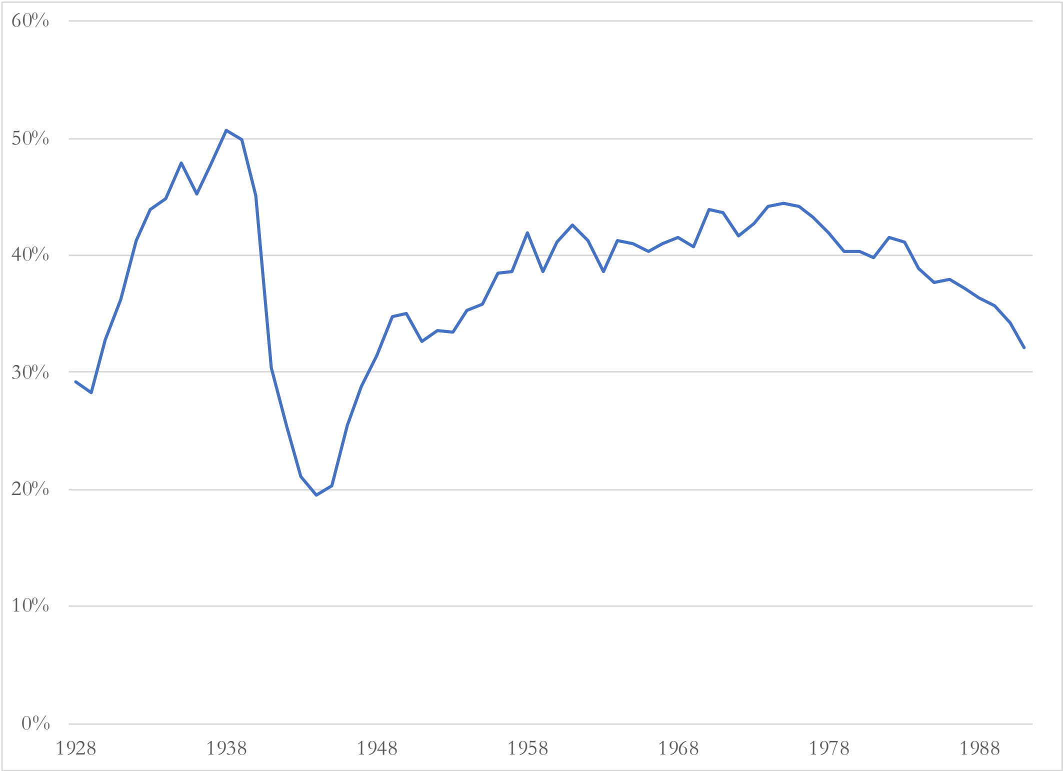
Source: Levy and Peart, 'Soviet Growth & American Textbooks.'

The majority view exemplified by Samuelson and Galbraith was of course wrong. Despite Schumpeter's pessimism, capitalism survived precisely because socialism did not work. After 1945, according to Angus Maddison's estimates, the Soviet economy was never more than 44 percent the size of that of the United States. By 1991, Soviet GDP was less than a third of

U.S. GDP. The tendency of American intelligence experts was to exaggerate the extent of Soviet success. But those who visited the Soviet Union could hardly miss its inferiority. Henry Kissinger noted the almost naïve desire of the Soviet leader Leonid Brezhnev to impress his American guests when he played host to an American diplomatic delegation at Zavidovo, the Politburo hunting preserve northeast of Moscow, in May 1973. Brezhnev invited Kissinger and his colleagues to dinner at his villa,

> which he first showed off with all the pride of a self-made entrepreneur. He asked me how much such an establishment would cost in the United States. I guessed tactlessly and mistakenly at four hundred thousand dollars. Brezhnev's face fell. My associate Helmut Sonnenfeldt was psychologically more adept: Two million, he corrected—probably much closer to the truth. Brezhnev, vastly reassured, beamed.[9]

Figure 2. USSR gross domestic product as a percentage of U.S. total (purchasing power parity basis, 1990 international dollars), 1928-1991



Source: http://www.ggdc.net/maddison/Historical_Statistics/vertical-file_02-2010.xls

Moreover, beginning in around 1979, the very term 'socialism' went into a decline, at least in the English-speaking world. Use of 'capitalism' also declined—as the two terms were in some senses interdependent, often appearing on the same page—but not as much. This was a humiliating reversal of fortune; socialism had led from the second half of the nineteenth century until the mid 1920s, and again in the 1960s and 1970s.

Figure 3. Capitalism and socialism in English-language publications, 1840-2008

Source: https://books.google.com/ngrams

II

The terms ‘capitalism’ and ‘socialism’ had their origins in the British Industrial Revolution. As the Chicago economist Thorstein Veblen argued, nineteenth-century capitalism was an authentically Darwinian system, characterized by seemingly random mutation, occasional speciation and differential survival.[10] Yet precisely the volatility of the more or less unregulated markets created by the Industrial Revolution caused consternation amongst many contemporaries. Until there were significant breakthroughs in public health, mortality rates in industrial cities were markedly worse than in the countryside. Moreover, the advent of a new and far from regular ‘business cycle,’ marked by periodic crises of industrial over-investment and financial panic, generally made a stronger impression on people than the gradual increase in the economy’s average growth rate. Though the Industrial Revolution manifestly improved life over the long run, in the short run it seemed to make things worse.

Intellectuals, as Schumpeter observed, were not slow to draw attention to this shadow side. One of William Blake's illustrations for his preface to *Milton* featured, amongst other somber images, a dark-skinned figure holding up a blood-soaked length of cotton yarn. For the composer Richard Wagner, London was 'Alberich's dream come true—Nibelheim, world dominion, activity, work, everywhere the oppressive feeling of steam and fog.' Hellish images of the British factory inspired his depiction of the dwarf's underground realm in *Das Rheingold*, as well as one of the great leitmotifs of the entire *Ring* cycle, the insistent, staccato rhythm of multiple hammers.

Steeped in German literature and philosophy, the Scottish philosopher Thomas Carlyle was the first to identify what seemed the fatal flaw of the industrial economy: that it reduced all social relations to what he called, in his great essay *Past and Present*, 'the cash nexus':

> the world has been rushing on with such fiery animation to get work and ever more work done, it has had no time to think of dividing the wages; and has merely left them to be scrambled for by the Law of the Stronger, law of Supply-and-demand, law of Laissez-faire, and other idle Laws and Un-laws. We call it a Society; and go about professing openly the totalest separation, isolation. Our life is not a mutual helpfulness; but rather, cloaked under due laws-of-war, named 'fair competition' and so forth, it is a mutual hostility. We have profoundly forgotten everywhere that *Cash-payment* is not the sole relation of human beings … [It] is not the sole nexus of man with man,—how far from it! Deep, far deeper than Supply-and-demand, are Laws, Obligations sacred as Man's Life itself.[11]

That phrase—the ‘cash nexus’—so much pleased the son of an apostate Jewish lawyer from the Rhineland that he and his co-author, the heir of a Wuppertal cotton mill-owner, purloined it for the outrageous ‘manifesto’ they published on the eve of the 1848 Revolutions.

The founders of communism, Karl Marx and Friedrich Engels, were just two of many radical critics of the industrial society, but it was their achievement to devise the first internally consistent blueprint for an alternative social order. A mixture of Georg Wilhelm Friedrich Hegel’s philosophy, which represented the historical process as dialectical, and the political economy of David Ricardo, which posited diminishing returns for capital and an ‘iron’ law of wages, Marxism took Carlyle’s revulsion against the industrial economy and substituted a utopia for nostalgia.

Marx himself was an odious individual. An unkempt scrounger and a savage polemicist, he liked to boast that his wife was ‘*née* Baroness von Westphalen’ but was not above siring an illegitimate son by their maidservant. On the sole occasion when he applied for a job (as a railway clerk) he was rejected because his handwriting was so atrocious. He sought to play the stock market but was hopeless at it. For most of his life he therefore depended on handouts from Engels, for whom socialism was an evening hobby, along with fox-hunting and womanizing; his day job was running one of his father’s cotton factories in Manchester (the patent product of which was known as ‘Diamond Thread’). No man in history has bitten the hand that fed him with greater gusto than Marx bit the hand of King Cotton.

The essence of Marxism was the belief that the industrial economy was doomed to produce an intolerably unequal society divided between the bourgeoisie, the owners of capital, and a property-less proletariat. Capitalism inexorably demanded the concentration of capital in ever fewer hands and the reduction of everyone else to wage slavery, which meant being paid only 'that quantum of the means of subsistence which is absolutely requisite to keep the laborer in bare existence as a laborer.' In chapter 32 of the first tome of *Capital* (1867), Marx prophesied the inevitable denouement:

> Along with the constant decrease of the number of capitalist magnates, who usurp and monopolize all the advantages of this process of transformation, the mass of misery, oppression, slavery, degradation and exploitation grows; but with this there also grows the revolt of the working class …
>
> The centralization of the means of production and the socialization of labor reach a point at which they become incompatible with their capitalist integument. This integument is burst asunder. The knell of capitalist private property sounds. The expropriators are expropriated.

It is no coincidence that this passage has a Wagnerian quality, part *Götterdämmerung*, part *Parsifal*. But by the time the book was published the great composer had left the spirit of 1848 far behind. Instead it was Eugene Pottier's song 'The Internationale' that became the anthem of Marxism. Set to music by Pierre De Geyter, it urged the 'servile masses' to put aside their religious 'superstitions' and national allegiances, and to make war on the 'thieves' and their accomplices, the tyrants, the generals, princes and peers.

Before identifying why they were wrong, we need to acknowledge what Marx and his disciples were right about. Inequality did increase as a result of the Industrial Revolution. Between 1780 and 1830 output per laborer in the UK grew over 25 percent but wages rose barely 5 percent. The proportion of national income going to the top percentile of the population rose from 25 percent in 1801 to 35 percent in 1848. In Paris in 1820, around 9 percent of the population were classified as 'proprietors and *rentiers*' (living from their investments) and owned 41 percent of recorded wealth. By 1911 their share had risen to 52 percent. In Prussia, the share of income going to the top 5 percent rose from 21 percent in 1854 to 27 percent in 1896 and to 43 percent in 1913.[12] Industrial societies, it seems clear, grew more unequal over the course of the nineteenth century. This had predictable consequences. In the Hamburg cholera epidemic of 1892, for example, the mortality rate for individuals with an income of less than 800 marks a year was thirteen times higher than that for individuals earning over 50,000 marks.[13]

It was not necessary to be an intellectual to be dismayed by the inequality of industrial society. The Welsh-born factory-owner Robert Owen envisaged an alternative economic model based on co-operative production and utopian villages like the ones he founded at Orbiston in Scotland and New Harmony, Indiana.[14] It was in a letter to Owen, written by Edward Cowper in 1822, that the word 'socialism' in its modern sense first appears. An unidentified woman was, Cowper thought, 'well adapted to become what my friend Jo. Applegath calls a Socialist.' Five years later, Owen himself argued that 'the chief question … between the modern … Political Economists, and the Communionists or Socialists, is whether it is more beneficial that this capital should be individual or in common.'[15] The term 'capitalism' made its debut in an English periodical in April 1833—in the London newspaper the *Standard*—in the phrase 'tyranny of capitalism,' part of an article on 'the ill consequences of that greatest curse that can exist amongst men, too much money-power in too few hands.'[16] Fifteen years later, the *Caledonian Mercury* referred with similar aversion to 'that sweeping tide of capitalism and money-loving which threatens our country with the horrors of a plutocracy.'[17]

Yet the revolution eagerly anticipated by Marx never materialized—at least, not where it was supposed to, in the advanced industrial countries. The great *bouleversements* of 1830 and 1848 were the results of short-run spikes in food prices and financial crises more than of social polarization.[18] As agricultural productivity improved in Europe, as industrial employment increased and as the amplitude of the business cycle diminished, the risk of revolution declined. Instead of coalescing into an impoverished mass, the proletariat subdivided into 'labor aristocracies' with skills and a *Lumpenproletariat* with vices. The former favored strikes and collective bargaining over revolution and thereby secured higher real wages. The latter favored gin. The respectable working class had their trade unions and working men's clubs.[19] The ruffians had the music hall and street fights.

The prescriptions of the *Communist Manifesto* were in any case singularly unappealing to the industrial workers they were aimed at. Marx and Engels called for the abolition of private property; the abolition of inheritance; the centralization of credit and communications; the state ownership of all factories and instruments of production; the creation of 'industrial armies for agriculture'; the abolition of the distinction between town and country; the abolition of the family; 'community of women' (wife-swapping) and the abolition of all nationalities. By contrast, mid-nineteenth-century liberals wanted constitutional government, the freedoms of speech, press and assembly, wider political representation through electoral reform, free trade and, where it was lacking, national self-determination ('Home Rule'). In the half-century after the upheaval of 1848 they got a great many of these things—enough, at any rate, to make the desperate remedies of Marx and Engels seem *de trop*. In 1850 only France, Greece and Switzerland had franchises in which more than a fifth of the population got to vote. By 1900 ten European countries did, and Britain and Sweden were not far below that threshold. Broader representation led to legislation that benefited lower-income groups; free trade in Britain meant cheap bread, and cheap bread plus rising nominal wages thanks to union pressure meant a significant gain in real terms for workers. Building laborers' day wages in London doubled in real terms between 1848 and 1913. Broader representation also led to more progressive taxation. Britain led the way in 1842 when Sir Robert Peel introduced a peacetime income tax; by 1913 the standard rate was 14 pence in the pound. Prior to 1842 nearly all British tax revenue had come from the indirect taxation of consumption, via customs and excise duties, regressive taxes that take a proportionately smaller amount of your income the richer you are. By 1913 a third of revenue was coming from direct taxes on the relatively rich. In 1842 the central government had spent virtually nothing on education and the arts and sciences. In 1913 those items accounted for 10 percent of expenditure. By that time, Britain had followed Germany in introducing a state pension for the elderly.

Marx and Engels were wrong on two scores, then. First, their iron law of wages did not exist. Wealth did indeed become highly concentrated under capitalism, and it stayed that way into the second quarter of the twentieth century, but income differentials began to narrow as real wages rose and taxation became less regressive. Capitalists understood what Marx missed: that workers were also consumers. It therefore made no sense to try to grind their wages down to subsistence levels. On the contrary, as the case of the United States was making increasingly clear, there was no bigger potential market for capitalist enterprises than their own employees. Far from condemning the masses to 'immiseration,' the mechanization of textile production created growing employment opportunities for Western workers—albeit at the expense of Indian spinners and weavers—and the decline in the prices of cotton and other goods meant that Western workers could buy more with their weekly wages. The impact is best captured by the exploding differential between Western and non-Western wages and living standards in this period. Even within the West the gap between the industrialized vanguard and the rural laggards widened dramatically. In early seventeenth-century London, an unskilled worker's real wages were not so different from what his counterpart earned in Milan. From the 1750s until the 1850s, however, Londoners pulled far ahead. At the peak of the great divergence within Europe, London real wages were six times those in Milan. With the industrialization of northern Italy in the second half of the nineteenth century, the gap began to close, so that by the eve of the First World War it was closer to a ratio of 3:1. German and Dutch workers also benefited from industrialization, though even in 1913 they still lagged behind their English counterparts.[20]

Chinese workers, by contrast, did no so such catching up. Where wages were highest, in the big cities of Beijing and Canton, building workers received the equivalent of around 3 grams of silver per day, with no upward movement in the eighteenth century and only a slight improvement in the nineteenth and early twentieth (to around 5-6 grams). There was some improvement for workers in Canton after 1900 but it was minimal; workers in Sichuan stayed dirt poor. London workers meanwhile saw their silver-equivalent wages rise from around 18 grams between 1800 and 1870 to 70 grams between 1900 and 1913. Allowing for the cost of maintaining a family, the standard of living of the average Chinese worker fell throughout the nineteenth century. True, subsistence was cheaper in China than in North-western Europe. It should also be remembered that Londoners and Berliners by that time enjoyed a far more variegated diet of bread, dairy products and meat, washed down with copious amounts of alcohol, whereas most East Asians were subsisting on milled rice and small grains. Nevertheless, it seems clear that by the second decade of the twentieth century the gap in living standards between London and Beijing was around six to one, compared with two to one in the eighteenth century.[21]

The second mistake Marx and Engels made was to underestimate the adaptive quality of the nineteenth-century state—particularly when it could legitimize itself as a *nation*-state. In his

Contribution to a Critique of Hegel's Philosophy of Right, Marx had famously called religion the 'opium of the masses.' If so, then nationalism was the cocaine of the middle classes.

Nationalism had its manifestos, too. Giuseppe Mazzini was perhaps the nearest thing to a theoretician that nationalism produced. As he shrewdly observed in 1852, the Revolution 'has assumed two forms; the question which all have agreed to call social, and the question of nationalities.' The Italian nationalists of the Risorgimento:

> struggled … as do Poland, Germany, and Hungary, for country and liberty; for a word inscribed upon a banner, proclaiming to the world that they also live, think, love, and labor for the benefit of all. They speak the same language, they bear about them the impress of consanguinity, they kneel beside the same tombs, they glory in the same tradition; and they demand to associate freely, without obstacles, without foreign domination …[22]

For Mazzini it was simple: 'The map of Europe has to be remade.' In the future, he argued, it would be neatly reordered as eleven nation-states. This was much easier said than done, however, which was why the preferred modes of nationalism were artistic or gymnastic rather than programmatic. Nationalism worked best in the demotic poetry of writers like the Greek Rigas Feraios ('It's better to have an hour as a free man than forty years as a slave'), or in the stirring songs of the German student fraternities ('The sentry on the Rhine stands firm and true'), or even on the sports field, where Scotland played England on St Andrew's Day, 1872, in the world's first international soccer match (result: 0–0). It was more problematic when political borders, linguistic borders and religious borders failed to coincide, as they did most obviously in the fatal triangle of territory between the Baltic, the Balkans and the Black Sea. Between 1830 and 1905 eight nation-states achieved either independence or unity: Greece (1830), Belgium

(1830–39), Romania (1856), Italy (1859–71), Germany (1864–71), Bulgaria (1878), Serbia (1867–78) and Norway (1905). But the American Southerners failed in their bids for statehood, as did the Armenians, the Croats, the Czechs, the Irish, the Poles, the Slovaks, the Slovenes and the Ukrainians. The Hungarians, like the Scots, made do with the role of junior partners in dual monarchies with empires they helped to run. As for such ethno-linguistically distinct peoples as the Roma, Sinti, Kashubes, Sorbs, Wends, Vlachs, Székelys, Carpatho-Rusyns and Ladins, no one seriously thought them capable of political autonomy.

Success or failure in the nation-building game was ultimately about *Realpolitik*. It suited Camillo Benso, conte de Cavour, to turn the rest of Italy into a colonial appendage of Piedmont-Sardinia, just as it suited Otto Eduard Leopold von Bismarck, Count of Bismarck-Schönhausen, to preserve the prerogatives of the Prussian monarchy by making it the most powerful institution in a federal German *Reich*. 'If we want everything to stay as it is, everything will have to change.' The most famous line in Giuseppe Tomasi di Lampedusa's historical novel *The Leopard* (1958) is frequently cited to sum up the covertly conservative character of Italian unification. But the new nation-states were about more than just preserving the cherished privileges of Europe's beleaguered landowning elites. Entities like Italy or Germany, composites of multiple statelets, offered all their citizens a host of benefits: economies of scale, network externalities, reduced transaction costs and the more efficient provision of key public goods like law and order, infrastructure and health. The new states could make Europe's big industrial cities, the breeding grounds of both cholera and revolution, finally safe. Slum clearance, boulevards too wide to barricade, bigger churches, leafy parks, sports stadiums and above all more policemen—all these things transformed the great capitals of Europe, not least Paris, which Baron Georges Haussmann completely recast for Napoleon III. All the new states had imposing façades; even defeated Austria lost little time in reinventing itself as 'imperial-royal' Austria-Hungary, its architectural identity set in stone around Vienna's Ringstrasse.[23] But behind the façades there was real substance. Schools were built, the better to drum standardized national languages into young heads. Barracks were erected, the better to train the high-school graduates to defend their fatherland. And railways were constructed in places where their profitability looked doubtful, the better to transport the troops to the border, should the need arise. Peasants became Frenchmen—or Germans, or Italians, or Serbs, depending where they happened to be born.

So effective was the system of nation-building that when the European governments resolved to go to war over two arcane issues—the sovereignty of Bosnia-Herzegovina and the neutrality of Belgium—they were able, over more than four years, to mobilize in excess of 70 million men as soldiers or sailors. In France and Germany around a fifth of the pre-war population—close to 80 percent of adult males—ended up in uniform. When the leaders of European socialism met in Brussels at the end of July 1914, they could do little more than admit their own impotence. A general strike could not halt a world war.

III

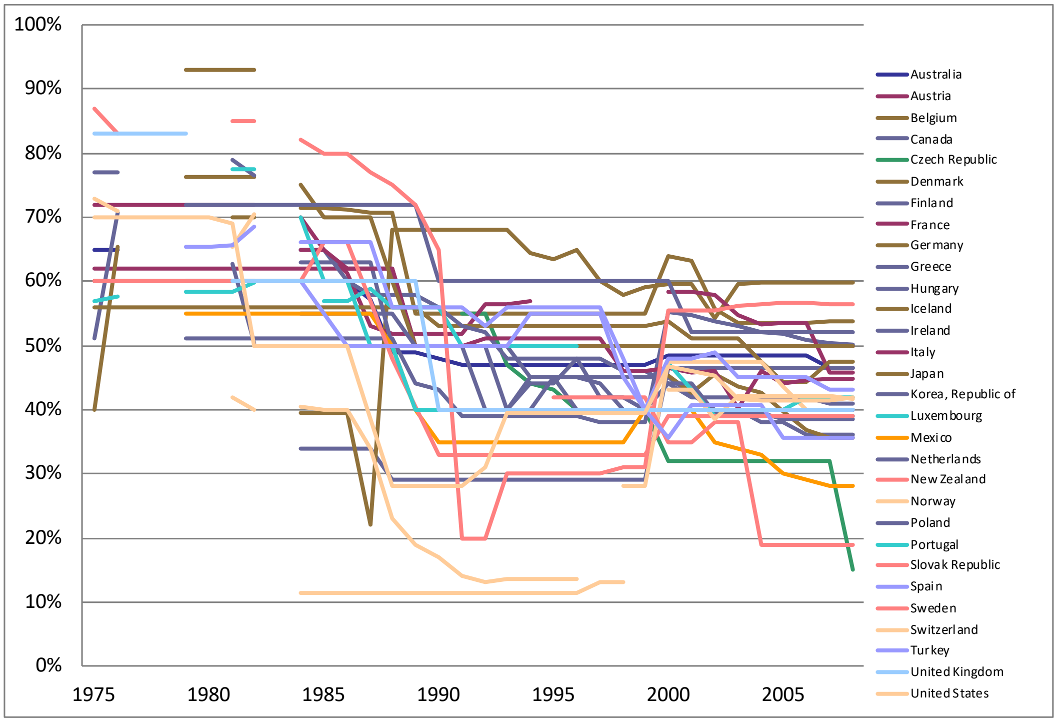
What gave socialism a shot was that the hypertrophic nationalism of the first half of the twentieth century plunged the world into not just one but two world wars. Without these catastrophes, it is inconceivable that so many devotees of Marx would have come to power in the seventy years after 1917. The world wars made the case for socialism in multiple ways. First, they seemed to confirm the destructive tendencies of 'imperialism, the highest form of capitalism.' Second, they greatly expanded the role of the state, which became the principal purchaser of goods and services in most combatant countries, creating precisely the kind of state-controlled economy that socialist theory claimed would perform better than free markets. Third, the wars acted as a great leveler, imposing very high marginal rates of taxation, wage controls and price controls in ways that tended to reduce wealth and income disparities. Fourth, in 1917 the German government financed the Bolshevik coup in Russia that brought Lenin to power.

The tragedy was that those who promised utopia generally delivered hell on earth. According to the estimates in the *Black Book of Communism*, the 'grand total of victims of Communism was between 85 and 100 million' for the twentieth century as a whole.[24] The lowest estimate for the total number of Soviet citizens who lost their lives as a direct result of Stalin's policies was more than 20 million, a quarter of them in the years after World War II.[25] Mao alone, as Frank Dikötter has shown, accounted for tens of millions: two million between 1949 and 1951, another three million by the end of the 1950s, a staggering 45 million in the man-made famine known as the 'Great Leap Forward,' yet more in the mayhem of the Cultural Revolution.[26] Even the less bloodthirsty regimes of Eastern Europe killed and imprisoned their citizens on a shocking scale.[27] In the Soviet Union, 2.75 million people were in the Gulag at Stalin's death. The numbers were greatly reduced thereafter, but until the very end of the Soviet system its inhabitants lived in the knowledge that there was nothing but their own guile to protect them from an arbitrary and corrupt state. Other communist regimes around the world, including the very durable dictatorships in North Korea and Cuba, were strikingly similar in the miseries they inflicted on their own citizens.

The various socialist regimes could not even justify their murderous behavior by providing those they spared with higher living standards than their counterparts living under capitalism. On the contrary, they were economically disastrous. The collectivization of agriculture invariably reduced farming productivity. A substantial proportion of the victims of Communism lost their lives because of the famines that resulted from collectivization in the Soviet Union and China. North Korea had a similarly disastrous experience. Central planning was a miserable failure for reasons long ago identified by Ludwig von Mises, Friedrich Hayek and Janos Kornai, amongst others. Indeed, the economic performance of strictly socialist countries got worse over time because of rigidities and perverse incentives institutionalized by planning.[28]

Moreover, the evidence is clear that, as countries moved away from socialist policies of state ownership and towards a greater reliance on market forces, they did better economically. The most striking example—but one of many—is that of China, which achieved a true great leap forward in economic output after beginning to dismantle the restrictions on private initiative in 1978. After the collapse of 'real existing socialism' in Central and Eastern Europe in 1989 and the dissolution of the Soviet Union in 1991, there was widespread recognition (the 'Washington consensus') that all countries would benefit from reducing state ownership of the economy through privatization and lowering marginal tax rates. As figure 4 shows, the highest marginal personal income tax rate was reduced in nearly all OECD countries between the mid 1970s and mid 2000s.

Figure 4: Top marginal personal income tax rates, OECD, 1975-2008



Source: OECD.

IV

By 2007, socialism seemed dead almost everywhere. Only the most ardent believers could look at Cuba or Venezuela—much less North Korea—as models offering a better life than capitalism. Even when the era of globalization and deregulation ended in the disarray of the global financial crisis, socialism did not initially show much sign of making a comeback. In most countries, the financial crisis of 2008-9 was more politically beneficial to the populists of the right, illustrating that, as in the 19th century, national identity tended to trump class consciousness whenever the two came into conflict.

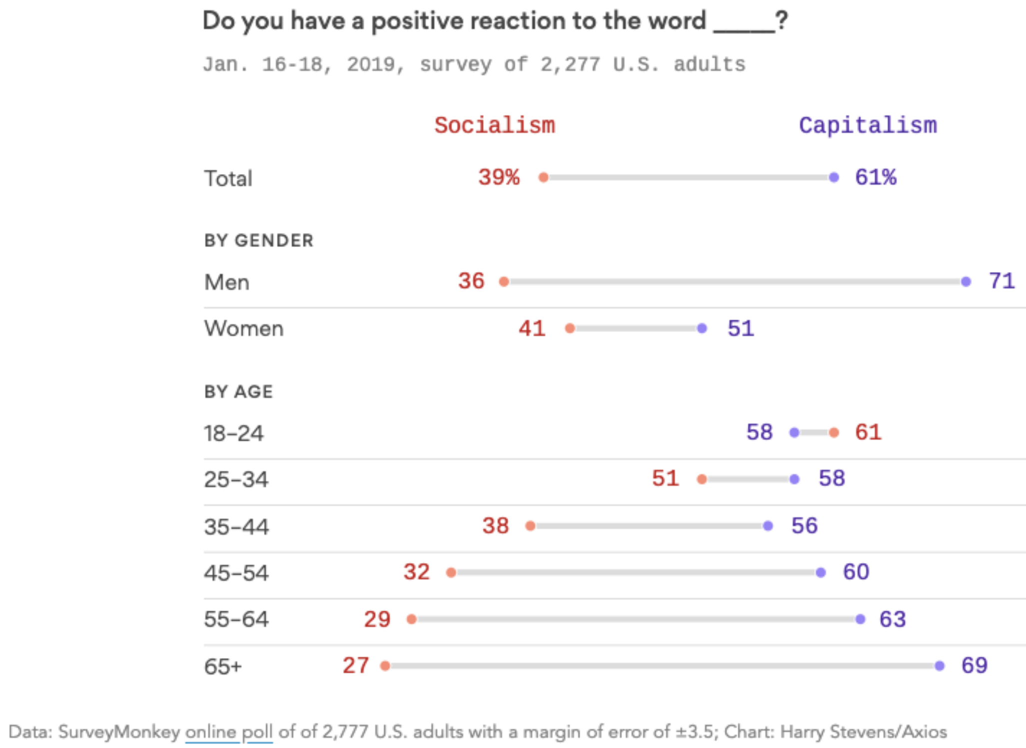
Why, then, has socialism come back into vogue in our time—and in America, of all places?

To answer this question, it is helpful to turn back to Schumpeter. It will be remembered that he argued, first, that capitalism's propensity for 'creative destruction' was also a source of weakness; second, that capitalism tends towards oligopoly, not perfect competition; third, that capitalism 'creates, educates and subsidizes a vested interest in social unrest,' namely intellectuals; and, finally, that socialism is politically attractive to bureaucrats and (many) democratic politicians. All four tendencies are visible in the United States today. Although policymakers have been successful in reducing the volatility of output and the rate of unemployment since the financial crisis—and very successful in raising the prices of financial assets above their pre-crisis level—the relative losers of the past decade have been succumbing in alarming numbers to what Case and Deaton have called 'deaths of despair.'[29] A number of authors have noted the decline in competition that has afflicted the United States in the recent past, most obviously but by no means only in the information technology sector, which has come to be dominated by a handful of network platforms.[30] The American academy is now skewed much further to the left than it was in Schumpeter's time. And, just as Schumpeter might have anticipated, a new generation of 'progressive' politicians has come forward with the familiar promises to soak the rich to fund new and bureaucratic entitlement programs. It is noteworthy that younger Americans—nine out of ten of whom now pass through the country's left-leaning college system—are disproportionately receptive to these promises.

A fear that Hayek raised in *The Constitution of Liberty* was that of future generational conflict. 'Most of those who will retire at the end of the century,' he wrote, 'will be dependent on the charity of the younger generation. And ultimately not morals but the fact that the young supply the police and the army will decide the issue: concentration camps for the aged unable to maintain themselves are likely to be the fate of an old generation whose income is entirely dependent on coercing the young.'[31] Things have not quite worked out that way. A significant portion of older Americans are well provided for with substantial shares of total household wealth—much larger shares than younger generations seem likely to accumulate in the prime of life. Nor do the police and army look likely to be agents of generational warfare. Nevertheless, the recent inter-generational divergence of attitudes towards economic policy suggests that he may have been right to worry about the young.[32]

New York Representative Alexandria Ocasio-Cortez is often portrayed as an extremist for the democratic socialist views that she espouses. However, survey data show that her views are close to the median for her generation. The Millennials and Generation Z—that is, Americans aged 18 to 38—are burdened by student loans and credit card debt. Millennials' early working lives were blighted by the financial crisis and the sluggish growth that followed. In later life, absent major changes in fiscal policy, they seem unlikely to enjoy the same kind of entitlements enjoyed by current retirees. Under different circumstances, the under-39s might conceivably have been attracted to the entitlement-cutting ideas of the Republican Tea Party (especially if those ideas had been sincere). Instead, we have witnessed a shift to the political left by young voters on nearly every policy issue, economic and cultural alike. As figure 5 shows, it is the youngest voters in American who are most attracted to socialism, to the extent that those aged under 25 profess to prefer it to capitalism. This must be a matter of serious concern for Republicans, as ten years from now, if current population trends hold, Gen Z and Millennials together will make up a majority of the American voting-age population. Twenty years from now, they will represent 62 percent of all eligible voters.

Figure 5: Attitudes to socialism and capitalism by age cohort, United States, 2019



Source: SurveyMonkey.

Of course, it depends what is meant by 'capitalism.' According to a 2018 Gallup poll, just 56 percent of all Americans have a positive view of capitalism. However, 92 percent have a positive view of 'small business,' 86 percent have positive view of 'entrepreneurs' and 79 percent have a positive view of 'free enterprise.' It also depends what is meant by 'socialism.' Asked by Gallup to define socialism, a quarter of Democrats (and Republicans) said it meant equality; 13 percent of Democrats saw it as government services, such as free health care; around the same proportion thought that socialism implied government ownership. (About 6 percent believed that socialism meant being social, including activity on social media.)

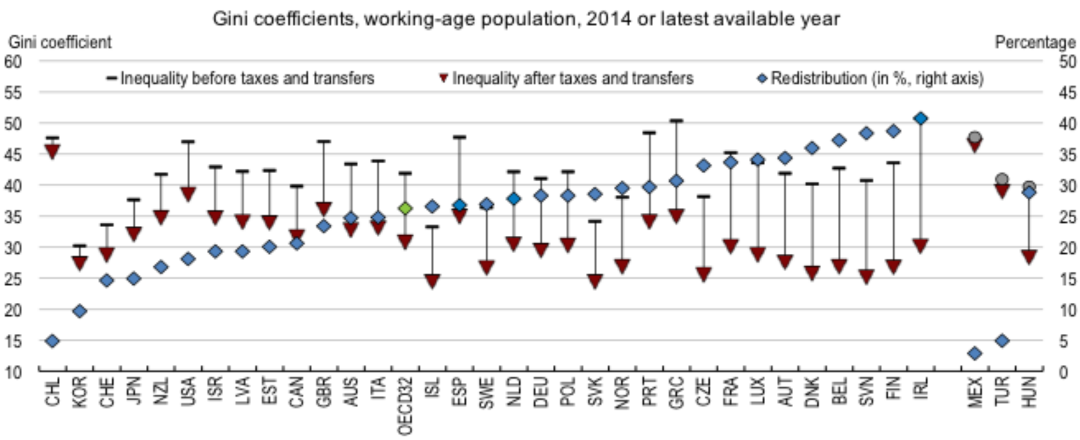
Asked by Anderson Cooper to define socialism, Ocasio-Cortez replied: 'What we have in mind and what my policies most closely re-resemble are what we see in the UK, in Norway, in

Finland, in Sweden.' But just how socialist is Sweden today? The country is 9th in the World Economic Forum's Competitiveness ranking, 12th in the World Bank's Ease of Doing Business league table, and 19th in Heritage's Economic Freedom ladder. Many young Americans seem to have in mind the 1970s, rather than the present, when they wax lyrical about Swedish socialism.

So what does American socialism amount to? According to a Harvard poll, 66 percent of Gen Z support single-payer health care. Slightly fewer (63 percent) support making public colleges and universities tuition-free. The same share supports Ocasio-Cortez's proposal to create a federal jobs guarantee. Many Gen Z voters are not yet in the workforce, but nearly half (47 percent) support a 'militant and powerful labor movement.' Millennial support for these policies is lower, but only slightly. Although wary of government in the abstract, young Americans nevertheless embrace it as the solution to the problems they perceive. Among voting-age members of Gen Z, seven in ten believe that the government 'should do more to solve problems' and 'has a responsibility to guarantee health care to all.'

These polling results strongly suggest that what young Americans mean by 'socialism' is nothing of the kind. What they have in mind is not the state taking over ownership of the means of production, which is the true meaning of socialism. They merely aspire to policies on healthcare and education that imply a more European system of fiscal redistribution, with higher progressive taxation paying for cheaper or free healthcare and higher education. As figure 6 shows, OECD countries vary widely in the extent to which they reduce inequality by means of taxes and transfers. At one extreme, is Chile, which only minimally reduces its Gini coefficient through its fiscal system; at the other is Ireland, which would be an even less egalitarian than Chile without taxes and transfers, but which reduces inequality by more than any other OECD country through the various levers of fiscal policy. American voters may one day opt for an Irish level of egalitarianism, but it would be a mistake to regard this is a triumph for socialism. So long as it is a large private sector that is being taxed to pay for the benefits being disbursed to lower income groups, socialism is not *le most juste*.

Figure 6: Gini coefficients and effects of fiscal policy, OECD countries, c. 2014



Source: OECD

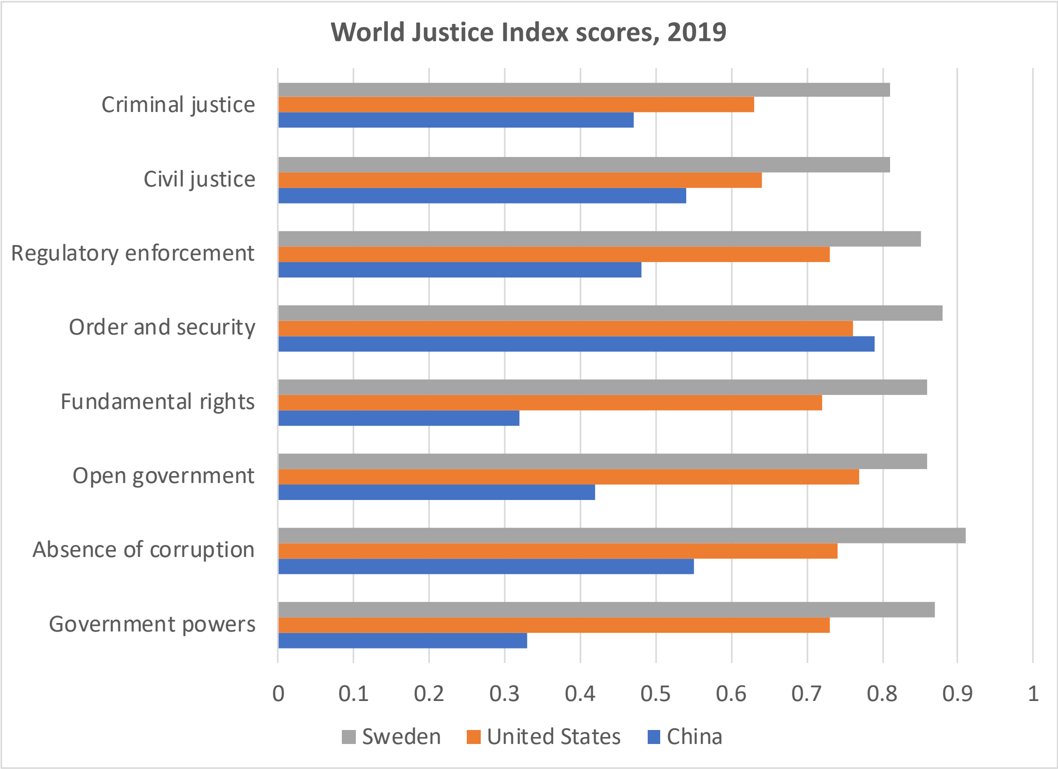
A final cause of confusion that remains to be resolved is what to make of ‘socialism with Chinese characteristics’? According to the *Economist*, ‘The non-state sector contributes close to two-thirds of China’s GDP growth and eight-tenths of all new jobs.’ Clearly, the most dynamic Chinese corporations—Alibaba and Tencent, for example—are not state-owned enterprises. The state sector has shrunk in relative terms significantly since the beginning of economic reform in the late 1970s. A common conclusion drawn by many Western visitors is that China is now socialist in name only; functionally it is a capitalist economy.

One objection to that conclusion is that, since the accession to power of Xi Jinping, there has been a deliberate revival of the state sector. In 2012, for example, private sector companies received 52 percent of new loans issued by the official bank sector, compared with 32 percent to

SOEs. But in 2016 private companies received just 11 percent of new loans, while more than 80 percent flowed to SOEs. The balance has shifted back in the other direction in more recent years, but the central government retains an option to direct credit in this discriminatory way, just as it relies on capital controls to prevent Chinese investors sending more money of their abroad, and on anti-corruption procedures to confiscate the property of officials and businessmen deemed to have transgressed.

Schumpeter largely omitted from his analysis an important variable which helps explain why socialism did not prevail in most countries in the second half of the twentieth century—namely, the rule of law. Because socialism at root means a violation of private property rights—the forced acquisition of assets by the state, with or without compensation—the most effective barrier to its spread is in fact an independent judiciary and a legal tradition that protects property owners from arbitrary confiscation. A common error made in the wake of the 1989 revolutions was to argue that it was capitalism and democracy that were interdependent, whereas in reality it is capitalism and the rule of law. On this basis, it is striking not only that China is so much inferior to the United States by most measures in the World Justice Index, but also that Sweden is some way ahead of the United States.

Figure 7: World Justice Index scores for China, Sweden and the United States, 2019



Source: World Justice Project.

The defining characteristic of socialist states is not their lack of democracy, but their lack of law. So long as China does not introduce a meaningful reform of the law—creating an independent judiciary and a truly free legal profession—all property rights in that country are contingent on the will the Communist Party. It is perhaps worth adding that, precisely because property rights in a socialist state are so constrained, there is almost no limit to the negative externalities that can be foisted on citizens and neighboring countries by polluting state enterprises (see figure 8).

Figure 8: Carbon dioxide emissions, 2007-2018

Million tonnes of carbon dioxide	2007	2018	Share of total emissions 2018	Percentage change 2007-2018	*Share of increase 2007-2018*
Canada	551	550	1.6%	-0.2%	*0.0%*
Mexico	429	462	1.4%	7.8%	*0.9%*
US	5,861	5,145	15.2%	-12.2%	*0.0%*
Total North America	6,841	6,158	18.2%	-10.0%	*0.0%*
Brazil	351	442	1.3%	26.0%	*2.4%*
Total S. & Cent. America	1,103	1,287	3.8%	16.7%	*4.8%*
Europe	5,008	4,248	12.5%	-15.2%	*0.0%*
Total CIS	1,963	2,100	6.2%	7.0%	*3.6%*
Total Middle East	1,511	2,119	6.3%	40.2%	*15.8%*
Total Africa	958	1,235	3.6%	28.8%	*7.2%*
China	7,240	9,429	27.8%	30.2%	*56.9%*
India	1,366	2,479	7.3%	81.5%	*29.0%*
Indonesia	387	543	1.6%	40.5%	*4.1%*
Total Asia Pacific	12,663	16,744	49.4%	32.2%	*106.2%*

Source: BP.

Nearly eighty years ago, Schumpeter was right to identify the inbuilt weaknesses of capitalism and the strengths of socialism, and to perceive that democracy alone would not necessarily uphold the free market system. He correctly identified the enemies within, which would turn against capitalism even in its most propitious habitat, the United States. He did not, however, spend enough time thinking about what institutions might be counted upon to defend capitalism against socialism. In a characteristically sarcastic passage setting out the supposed benefits of socialism, Schumpeter notes that:

> A considerable part of the total work done by lawyers goes into the struggle of business with the state and its organs. It is immaterial whether we call this vicious obstruction of the common good or defense of the common good against vicious obstruction. In any case the fact remains that in socialist society there would be neither need nor room for this part of legal activity. The resulting saving is not satisfactorily measured by the fees of the lawyers who are thus engaged. That is inconsiderable. But not inconsiderable is the

> social loss from such unproductive employment of many of the best brains. Considering how terribly rare good brains are, their shifting to other employments might be of more than infinitesimal importance.[33]

Conspicuously, Schumpeter did not subsequently acknowledge that defending business against the state is in fact an economically beneficial activity, insofar as it upholds the rights of private property and makes it difficult to violate them. Perhaps he did not feel that he needed to state something so obvious. Yet sometimes it is the responsibility of a public intellectual to do just that.

What makes socialism pernicious is not so much the inefficiency that invariably attends state ownership of any asset, as the erosion of property rights that tends inevitably to be associated with the state's acquisition of private assets. Where—as in Sweden in the 1950s and 1960s—socialists acquired a dominant political position without overthrowing property rights in pursuit of direct state ownership, it proved possible to roll it back, once the inefficiencies of state control became apparent.[34] But where—as in China or Venezuela—the rule of law has essentially ceased to exist, such self-correction becomes almost impossible. The socialist economy can then go down only one of two possible paths: towards authoritarianism, to rein in the oligarchs and carpetbaggers, or towards anarchy. This is a lesson that young Americans might have been taught at college. It is unfortunate that, as Schumpeter predicted, the modern American university is about the last place one would choose to visit if one wished to learn the truth about the history of socialism.

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Notes

[1] Schumpeter, *Capitalism, Socialism and Democracy*, pp. 61, 167.

[2] McCraw, *Prophet of Innovation*, pp. 307ff., 317.

[3] Ibid., pp. 350ff.

[4] Levy and Peart, 'Fragility of a Discipline,' pp. 131-135.

[5] Levy and Peart, 'Soviet Growth & American Textbooks.'

[6] Bockman, *Markets in the Name of Socialism*.

[7] Ibid.

[8] On Nutter, see Magness, 'Soviet Economy.' Nutter had the distinction of being the first of Milton Friedman's doctoral students to embark on an academic career.

[9] Kissinger, *Years of Upheaval*, p. 229.

[10] Ferguson, 'Evolutionary Approach.'

[11] Carlyle, *Past and Present*, Book I, chs. 1-4, Book IV, chs. 4, 8.

[12] Kaelble, *Industrialization and Social Inequality*.

[13] Evans, *Death in Hamburg*.

[14] Grayling, *Light of Liberty*, pp. 189-93.

[15] Sloane, Women in the Room, p. 37.

[16] *The Standard*, April 23, 1933.

[17] *Oxford English Dictionary*.

[18] Berger and Spoerer, 'Economic Crises.'

[19] See e.g. Fowler, *Lancashire Cotton Operatives*.

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[21] Allen et al., 'Wages, Prices, and Living Standards.'

[22] Mazzini, 'To the Italians.'

[23] Schorske, *Fin-de-Siècle Vienna*.

[24] Courtois et al., *Black Book of Communism*.

[25] Rummel, *Lethal Politics*.

[26] Dikötter, *Tragedy of Liberation*; idem, *Mao's Great Famine*.

[27] Applebaum, *Iron Curtain*.

[28] White House, *Economic Report of the President*, pp. 381-426.

[29] Case and Deaton, 'Mortality and Morbidity.'

[30] Tepper, *Myth of Capitalism*.

[31] Hayek, *Constitution of Liberty*, p. 258.

[32] Ferguson and Freymann, 'Coming Generation War.'

[33] Schumpeter, *Capitalism, Socialism and Democracy*, p. 198.

[34] Henriksen and Jakobsson, 'Where Schumpeter Was Nearly Right.'

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Magna Carta, the rule of law, and the limits on government

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ABSTRACT

This paper surveys the legal tradition that links *Magna Carta* with the modern concepts of the rule of law and the limits on government. It documents that the original understanding of the rule of law included substantive commitments to individual freedom and limited government. Then, it attempts to explain how and why such commitments were lost to a formalist interpretation of the rule of law from 1848 to 1939. The paper concludes by arguing that a revival of the substantive commitments of the rule of law is central to reshaping modern states.

> Such is the subject matter of legal history in the middle ages where we can follow the rise and progress of law and the rule of law... It was mediaevalists in England, armed with Bracton and the Year Books, who ended Stuart statecraft, and the Constitution of the United States was written by men who had Magna Carta and Coke upon Littleton before their eyes. Could anything be more mediaeval than the idea of due process, or the insertion in an instrument of government of a contract clause? *Pacta sunt servanda*, it seems to say, with the real mediaeval accent.
> Theodore Plucknett, *A Concise History of the Common Law*

1. Introduction

Reading *Magna Carta* is a disconcerting experience. Instead of an eloquent expression of natural rights, such as the U.S. Declaration of Independence, or a well-organized template for institutional design, such as the U.S. Constitution, *Magna Carta* is an archetypical legal document from the Middle Ages. The language, even when translated from Latin into 21st century English, is unfamiliar. The chapters (the numbering of which was a later introduction to ease reading) cluster without a pattern, more the product of the haste with which this 3550-word sheet of parchment was drafted than of serene reflection.[2] Most of the chapters, in addition, deal with feudal matters of little relevance to anyone except antiquarians. Other chapters, such as those dealing with the Jews, are offensive to contemporary sensibilities. After this reading, it is difficult not to agree with generations of historians who have conceptualized the Great Charter as a *lieu de mémoire*, a cognitive framework that sustains the collective beliefs of the English-speaking peoples in life, liberty, and property, instead of thinking about it as a relevant legal document.

And yet, a perceptive reader cannot but marvel at *Magna Carta*. Beyond the disappointments of looking at the real England of the early 13th century instead of at the Hollywood recreation we have grown accustomed to,[3] one finds in it the foundations of the "rule of law." As in all permanent texts, the brilliance of *Magna Carta* shines even more brightly thanks to all its shortcomings.

Let us look, for example, at chapter 17[4]:

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[1] I want to thank Richard Epstein, Shruti Rajagopalan, and Mario Rizzo for inviting me to the symposium commemorating 800 Years of the Magna Carta at the NYU School of Law and for generous comments. I also thank the participants at the symposium for their feedback and the Hoover Institution for supporting this research. A longer version of this paper (including an appendix with additional discussions) is available at http://ssrn.com/abstract=2676184.

[2] Vincent (2012) provides a concise, yet insightful treatment of *Magna Carta*, the coronation charters that preceded it, and its later role in English history. J. C. Holt's (1965) *Magna Carta* is, nevertheless, still the classic reference.

[3] See, for an amusing yet scholarly exploration of this imaginary, Pugh and Aronstein (2012).

[4] http://www.bl.uk/magna-carta/articles/magna-carta-english-translation.

http://dx.doi.org/10.1016/j.irle.2016.05.006
0144-8188/

(17) Ordinary lawsuits shall not follow the royal court around, but shall be held in a fixed place.

This chapter sets up a concise and clear procedural rule: the adjudication of legal disputes cannot occur wherever the King's whim may drive him, but will take place at a predetermined location. What hope of a successful resolution of disputes can we have if we do not even know where they will be adjudicated? Or what about chapters 30–32 and their protection of property rights?

(30) No sheriff, royal official, or other person shall take horses or carts for transport from any free man, without his consent.
(31) Neither we nor any royal official will take wood for our castle, or for any other purpose, without the consent of the owner.
(32) We will not keep the lands of people convicted of felony in our hand for longer than a year and a day, after which they shall be returned to the lords of the 'fees' concerned.

These four chapters are the kernel of legal doctrines of a more general nature. One does not need to be an inventive English barrister to argue that, by analogy with chapter 17, if ordinary lawsuits should be heard in a fixed place, the other rules that govern a judicial process should also be predetermined. For chapter 17 is not defending the supremacy of a concrete physical location (in itself an issue of minor importance), but is an understanding of how an adjudication should proceed according to the principles of natural reason. Indeed, this point is reinforced by chapters 19 and 40 regarding due process and a prompt trial. Similarly, chapters 30 and 31 of *Magna Carta* mention horses, carts, and wood because they were the most valuable pieces of movable property at the time for a median free man. But the general principle of respect for property rights, the goal of the Barons in Runnymede, should apply to all movable and immovable property. Historical experience suggests that, once we have ensured the combination of due process and the protection of property rights, the rest of the "rule of law" and, with it, a system of well-ordered liberty, follows.

But what exactly is the "rule of law"? This question is pertinent because, while jurists and politicians nearly unanimously praise this legal principle as a prerequisite for democracy and prosperity, scholars vehemently disagree about the actual content of this rule. As German lawyers love to say, law is full of indeterminate legal concepts (*unbestimmte Rechtsbegriff*). And few concepts seem more indeterminate than the "rule of law."

2. The interpretations of the rule of law

Tamanaha (2004) popularized a taxonomy of the different interpretations of the "rule of law." A **thin interpretation** states that the "rule of law" is a technical construction limited to formal conditions without material content. This formalist position is, perhaps, the one held most extensively among contemporary legal scholars (in particular, among those educated in the analytic tradition). Formal requirements (for instance, norms should be clear, prospective, and non-contradictory) are valuable because they allow the law to guide the behavior of the members of society. A **thick interpretation** of the "rule of law" adds a number of substantive commitments to the formal conditions of the thin interpretation, in particular, the respect for individual liberties. There are, as well, a full range of **intermediate positions** that go beyond a minimalist formalism and introduce limited substantive elements.

In the rest of the paper, I will engage, first, in an archeology of knowledge to demonstrate that the original understanding of the "rule of law" was the thick interpretation presented above. Second, I will show that there is a clear path linking *Magna Carta* with the thick interpretation of the "rule of law." And third, I will defend the thesis that restoring such an interpretation is key to rebuilding limited government in modern societies.

3. On the origins of the concept of the rule of law

The origins of the expression "rule of law" in English are uncertain. The first recorded use of the expression that the Oxford English Dictionary can find is by John Blount. Around 1500, Blount, a kinsman of William Blount, 4th Baron Mountjoy and a fellow at All Souls College, Oxford, translated into English some selected portions of Nicholas Upton's *De Studio Militari* (a forgettable 1447 treatise on heraldry and the military). Blount rendered the Latin *Juris regula* as (using the spelling of his time) the *Rewle of lawe*.[5]

Not only did the expression soon become common, but it acquired a role in rhetorical arguments defending the legitimacy (or lack thereof) of an exercise of power. In his *Declaration of August 12, 1642, to All His Loving Subjects*, a few days before raising his standard at Nottingham, the unfortunate Charles I noted[6]:

> The inconveniences and mischiefs which had grown by the long intermission of Parliaments, and by departing too much from the known Rule of Law, to an Arbitrary power.

3.1. A.V. Dicey

But despite these older uses, the expression "rule of law" only became widely popular after A.V. Dicey, 1835–1922) postulated in his classic 1885 treatise, *Introduction to the Study of the Law of the Constitution*, chapter IV, pp. 145–146, that the "rule or supremacy of law" was one of the two fundamental principles of the political institutions of England since the Norman conquest (the other, of course, being the supremacy of Parliament).

Generations of law students in the English-speaking world studied Dicey's treatise and became so well acquainted with these words that the adherence to the idea of the "rule of law" became a badge of professional competence.[7]

Dicey embraced a concept of the "rule of law" that was embodied in the English liberties. For Dicey, the law in the rule of law was the common law and its protection of individual freedoms. This substantive understanding of the "rule of law" is often forgotten because Dicey added later in the very same chapter IV three concrete contents of the "rule of law": due process, equality under the law, and case-law-based protection of liberties (pp. 179–187). While these three interrelated concepts may seem to be, at first sight, procedural mechanisms that push us toward a formalist reading, they must be interpreted instrumentally.

The first reason is that otherwise it is hard to understand the structure of Dicey's treatise. For instance, part II of the book, under the rubric "The Rule of Law," groups the chapters on the right to personal freedom or the freedom of discussion. Second, Dicey was a fervent Whig. The product of several generations of Clapham Sect members and radical publishers, Dicey could barely conceive any other political position except that of a solid Liberal Unionist.[8]

[5] The full passage reads: *Lawes And constitutcions be ordeyned be cause the noysome Appetit of man maye be kepte vnder the Rewle of lawe by the wiche mankinde ys dewly enformed to lyue honestly*, OED Third Edition, March 2011.

[6] Hart (2003) describes how the English construed their expectations about law and legitimacy during the early Stuart dynasty.

[7] There were, nevertheless, discontents. More famously, John Griffith, 1918–2010) and his students at the London School of Economics remained unconvinced. Griffith suspected that, beyond basic formal procedures, the "rule of law" was nothing but a thin veil to hide the inequities of class domination. See Loughlin (2010).

[8] This point was well understood by John Griffith, whom we introduced in Footnote 5. As he put it during the Seventh Chorley Lecture at the London School of Economics, the "rule of law" was "a fantasy invented by Liberals of the old school in the late-19th century and patented by the Tories to throw a protective sanctity

Due process, equality, and judges were just the means to defend English freedoms. Third, we have Dicey's rather low regard for French administrative law. French administrative legal regulations were more often than not beautiful examples of well-crafted norms that neatly complied with all formalist requirements: transparent, unequivocal, elegant, the outcomes of a rich tradition of superb civil servants. And yet, Dicey vehemently denied that *droit administratif* could achieve the "rule of law."

But Dicey was not inventing new ideas (see Arndt, 1957, or Cosgrove, 1980). Instead, his understanding of the "rule of law" follows a tradition in which *Magna Carta* stands as a fundamental milestone. In the next section, I will stop three times on the voyage from *Magna Carta* to Dicey. With only three stations, my description will have more gaps than content. I will forget about classical legal thought. I will forget, as well, about the legal tradition outside the English-speaking world (and there they go, with the stroke of a digital pen, from Saint Thomas Aquinas' *Treatise on Law* to Montesquieu's *De l'esprit des lois*, passing through the School of Salamanca and Hugo Grotius).[9] My three stops are selected as illustrations of the argument, even if that means leaving behind some more familiar names such as John Fortescue (c.1394–c.1480) or Michael Oakeshott or notable events such as the *Bill of Rights* of 1689 or *Entick v. Carrington*. The usual flimsy excuse of space constraints can be here vindicated with fairness: it would require an inordinate amount of pages (and expertise I sorely lack) to deal, even perfunctorily, with the ignored topics.

4. From 1215 to 1885: seven centuries of tradition

Since at least Roman times, western jurists have conceived of law as well-ordered reason aimed at the common good. While the details of law could change over time, as circumstances evolved and experience accumulated, the essence of legal systems (the *naturalis ratio* that Gaius talks about at the start of his *Institutes*) was permanent. A norm that does not respect those principles cannot be law and, therefore, there cannot be the "rule of law." This idea has resurfaced many times.

4.1. Henry de Bracton

Our first port of call is Henry de Bracton (c.1210–c.1268), who wrote just a few years after *Magna Carta*. In his famous *On the Laws and Customs of England* (in Latin, *De Legibus et Consuetudinibus Angliae*), Bracton called the great charter *constitutionem libertatis*, the constitution of liberty.

It is hard to exaggerate Bracton's influence on medieval English law or on the reception of Roman law concepts in Great Britain. Bracton displayed a sophisticated understanding of the "rule of law." He contended that the king is subject directly to the law, for law makes him king, and indirectly to his earls and barons, who check his power:

> The king has a superior, namely, God. Also the law by which he is made king. Also his curia, namely, the earls and barons, because if he is without bridle, that is without law, they ought to put the bridle on him.[10]

Two points are fundamental to interpreting Bracton. First, for Bracton, the sentence at the start of the first quote (*The king has a superior, namely, God*) is not a mere concession to the religious predispositions of his time. An invocation to a deity was a call to natural law, with its rich tapestry of moral and efficacy requisites that territorial rulers were bound to respect.[11] Second, for the jurist in the Middle Ages, law was found, not created. Rules could compile it, clarify it, publish it. Judges could adapt it to new circumstances. Legal scholars could explore its implications. But none of them could create law and, much less, eliminate its moral constraints. The law's "bridle" was, for Bracton, much more a constraint than any of us, educated in a world of hyperactive legislatures and a positivist Zeitgeist, can appreciate (this is a point made both by Hayek, 2011, and by Reid, 2004).

4.2. Sir Edward Coke

Our second stop on the path from *Magna Carta* to Dicey is Sir Edward Coke (1552–1634). Coke, baptized by Hayek in *The Constitution of Liberty* as "the great fountain of Whig principles," transformed *Magna Carta* into the cornerstone of the reassertion of the power of the English Parliament against the Stuart dynasty. Coke, with little regard for historical accuracy, considered *Magna Carta* an authoritative declaratory document of immemorial English liberties and reinterpreted much of its content. For example, in 1604, Coke found in chapter 39 of the original *Magna Carta* a justification for *habeas corpus*.

Coke deftly articulated his idea of the substantive commitments of the "rule of law" in 1610. In the decision of Dr. Bonham's case, Coke argued:

> for when an Act of Parliament is against Common right and reason, or repugnant, or impossible to be performed, the Common Law will control it, and adjudge such Act to be void.

Dr. Bonham's case is, as the concept of the "rule of law," often interpreted from a formalist position. The main argument for Coke's dismissal of the Act of Parliament that empowered the Royal College of Physicians to prosecute Dr. Bonham was the old maxim that *nemo judex in parte sua*: the College could not be both a judge and a party in deciding the fate of Dr. Bonham.

But the interesting part of Coke's decision is that he never limits his wording to this formal requirement. Indeed, Coke makes a much stronger claim (which he later repeated in other cases): a statute could satisfy all formal requirements (i.e., been approved by Parliament following procedure) and yet, by violating the principles implied by "common right and reason," it would be 1) subject to the common law and, thus, 2) void. Even if Coke does not use the expression "rule of law," his understanding of it was thick. More importantly, generations of lawyers in England and North America learned the substance of this idea (although not the expression) from him.[12]

around certain legal and political institutions and principles which they wish to preserve at any cost" (Griffith, 1979). One may disagree with Griffith's judgment of the consequences for human welfare of the "rule of law," but he is on the money in terms of recognizing the inherent substantive commitments of Dicey's conception of the "rule of law."

[9] Nothing is further from my intention than to imply any peculiarities of the English. As Vincent (2012) wittily remarks about the success of *Magna Carta* under Henry III, "England's liberties were won from a nine year-old Angevin king, provoked by a French invasion, and confirmed under the seal of an Italian cardinal."

[10] Volume 2, p. 110. I cannot resist quoting the original Latin, which has a poetic rhythm lacking in the translation: *legem per quam factus est rex*.

[11] In an erudite work, Helmholz (2015) has documented the importance of natural law from the Middle Ages onward both in the training of lawyers and in the court. See, for example, Lord Mansfield's (1705–1793) reasoning in *Somerset v. Stewart* (1772).

[12] Innumerable words have been written about Coke in general and about the Dr. Bonham case in particular. Not all, by far, agree with my interpretation. But the real importance of Dr. Bonham's case, like that of *Magna Carta*, is less about what Coke meant and more about how generations of thinkers read the case. And there is little doubt that the Dr. Bonham case was a fundamental piece in the construction of the classical liberal understanding of the "rule of law" (Stoner, 1992). For example,

4.3. The American founding

The last station on our trip is the American founding. The discussion about how the role of the "rule of law" has shaped our national adventure could fill several volumes. Having been educated in a legal system that separates its Kelsian Constitutional Court from the regular jurisdiction, I have, for example, spent an inordinate amount of time thinking about *Marbury v. Madison*, the origins of judicial review, its role in the concept of the "rule of law," and its impact on the world.

In that thinking, I have reached the conclusion that, instead of glossing Marshall's words yet one more time or fighting another battle about Article III of the Constitution, one can profit much from going to the earlier colonial times that framed the actions of Marshall and his contemporaries.

And right at the start of those colonial times, Nathaniel Ward (1578–1652), a pastor and a former barrister, compiled the *Massachusetts Body of Liberties*, adopted by the Massachusetts General Court in 1641. The statute, where one can find many traces of *Magna Carta* and the ideas built around it over the centuries, had a deep impact on colonial thinking and on the ideological constructions to sustain the rebellion against George III. Similar statutes were approved in Maryland (1639) and West New Jersey (1676). In my colony, Pennsylvania, William Penn ordered in 1687 the first printing of the whole text of *Magna Carta* in the Americas.[13]

Magna Carta also prominently appears in colonial pageantry. In a popular but not too subtle engraving from 1768, John Dickinson, author of *Letters from a Farmer in Pennsylvania*, is shown holding a manuscript of his book while resting on a volume entitled *Magna Carta*. In an even less subtle reference, the 1775 seal of the colony of Massachusetts displays a free citizen holding a copy of *Magna Carta* in one hand and a sword in the other. Fischer (2004) provides a fascinating record of the visual images of the American founding.

The road from the *Massachusetts Body of Liberties* to the Declaration of Independence, the Constitution, the Bill of Rights, and Marshall's tenure was long and tortuous, but it was open from the first day English colonists settled in Massachusetts Bay. Marshall did not create judicial review out of thin air. Instead, by declaring section 13 of the Judiciary Act of 1789 unconstitutional, Marshall culminated a long process that had transformed a peace treaty between John of England and his Barons into a constitutional design centered around a thick interpretation of the "rule of law."

5. Rule of law v. rule by norms

An implication of the legal inheritance I just described is the distinction between the "rule of law" and "rule by norms."[14] "Rule by norm" is an imperative of any modern government, including dictatorships. The sophistication of contemporary life and the complexities of advanced technology make it impossible to run efficiently a large organization without norms that satisfy at least several of the formalist requirements of the thin interpretation of the "rule of law" (clarity, non-contradiction, etc.).

An example of my assertion is Franco's Spain starting in the late 1950s. The pressures of modernization and the need to achieve a modicum of legitimacy through economic growth forced the construction, under the auspices of López Rodó – a well-regarded professor of administrative law – of a technically sharp administrative state.[15] Clear procedures were laid down and followed. Civil servants were selected largely on merit. Norms were public, expertly crafted, prospective, and unambiguous.[16] And yet, nothing vaguely resembling the "rule of law" existed in 1960s Spain.

An example of what happens when formal requirements are not followed is Germany between 1933 and 1945. Historians have documented how dysfunctional the national-socialist state was. Standard administrative rules were replaced by delphic principles such as "working towards the Führer." By 1938, the German state was a systemless polycracy: party against state, Wehrmacht against SS, ministry against agency (see Broszat, 1981; Kershaw, 1993). The resulting administrative chaos seriously handicapped Germany's war performance and accelerated the demise of the regime.[17]

6. The rise of the thin interpretation

But (i) if the thick interpretation of the rule of law is the product of the illustrious tradition presented in Section 4 and (ii) we have expressions to deal with the pure formalist content of the "rule of law" such as "rule by norms," why is the thin interpretation of the "rule of law" so popular nowadays? Two reasons are key.

6.1. The British constitution v. the English constitution

The British constitution of 1776 was not the English constitution of Coke. Instead of the complex system of interlocking checks and balances between the one (the King), the few (the Lords), and the many (the Commons) tempered by the common law, custom, and practices, the Glorious Revolution of 1688 and the subsequent Whig predominance had produced an aggressive and powerful House of Commons. When Sir William Blackstone (1723–1780) insisted on parliamentary sovereignty, he was merely stating a fact, perhaps more forcefully than his predecessors, but not breaking new ground.[18] When *Commentaries on the Laws of England* was published in North America, perceptive colonial lawyers understood that unlimited parliamentary sovereignty was a mortal threat to colonial liberties and self-government (Zweiben, 1990). Even if the problem of sending representatives across the Atlantic Ocean could somehow be managed, the small population of the colonies relative to that of England meant that the British Parliament could rule them without regard to their interests (as it often did with Scotland and

George Mason cited the Dr. Bonham case in *Robin et al. v. Hardaway et al.* to defend the freedom of some slaves since: "Now all acts of legislature apparently contrary to natural right and justice, are, in our laws, and must be in the nature of things, considered as void." John Marshall was familiar with *Robin et al. v. Hardaway et al.* and other cases in colonial Virginia that hinted at the idea of constitutional judicial review.

[13] The classic reference for the influence of *Magna Carta* in North America is still Dick Howard (1968). See Reid (2004) for the understanding of the "rule of law" in the 17th and 18th centuries in the English-speaking world and Pallitto (2015) for the impact of *Magna Carta* on case law.

[14] Often, "rule of law" is opposed to "rule by law" (see, for instance, Tamanaha, 2004, p. 92). I find the latter expression less useful than "rule by norms," Besides being phonetically easier to distinguish from "rule of law," one could imagine a society governed by rules that do not satisfy Fuller (1969)'s criteria for legality and, yet, can easily be construed as a nation ruled by norms.

[15] The cornerstone of such reform, the Administrative Procedure Act of 1958 (*Ley de 17 de julio de 1958, de Procedimiento Administrativo*), was so influential that small portions of it are still in the Spanish statute books 40 years *after* the end of Franco's regime.

[16] During the first two decades of the dictatorship, many statutes and regulations were kept secret. Viñas (2015) reports the last secret statute he has been able to track down is from 1957.

[17] See, for example, O'Brien (2015), for a description of Germany's mistakes in resource allocation during the war due to mismanagement.

[18] Sovereignty goes beyond supremacy. While the latter only implies predominance over other powers, the former brings domination over them. Sovereignty is indivisible and, ultimately, unshareable, as the colonials would slowly realize from 1765 to 1776. The move from parliamentary supremacy to parliamentary sovereignty is one of the key steps in the constitutional evolution of the 17th century United Kingdom. Parliamentary sovereignty was defended by the winners of 1688 and opposed both by Tory monarchists such as the Viscount Bolingbroke, who defended the King's traditional prerogatives, and by radicals such as John Wilkes, who feared the unbridled power of an oligarchy-controlled Parliament.

Wales, despite the presence in London of members of Parliament from those two nations).

This problem was not theoretical. After 1763, the British Parliament's attempts to assert its authority in the colonies were met with increasing resistance. Local leaders reacted by claiming their allegiance to the King, as a bulwark against Parliament (a point made by Nelson, 2014, who goes as far as calling the revolt a "royalist revolution"). Constitutionally speaking, no offense was bigger than the Declaratory Act of 1766 (officially, the *American Colonies Act*). It was only after the realization that George III was not the counterbalancing force that colonial elites had hoped for, that independence became an ineluctable choice.[19]

But once independence had been achieved and a Congress elected by the people regularly met in Washington, the old concerns about the unrestricted power of a legislature were forgotten. Instead, students of law were attracted to Blackstone's work, undoubtedly the best existing exposition of the common law,[20] or to treatises heavily influenced by it (such as James Kent's 1826 *Commentaries on American Law*). Imperceptibly, the idea of a sovereign legislator, where Westminster was all too easily replaced by Capitol Hill, took hold: the "rule of law" could not be anything more than the rule of statutes approved by Congress, regardless of their material content.[21]

6.2. From a Kantian Rechtsstaat to a Positivist Rechtsstaat

The second reason for the popularity of the thin interpretation of the rule of law comes from Germany and its large influence on the legal and political thought of the western world between 1815 and 1933.

In the German-speaking world, a cousin of the "rule of law" had been born: the *Rechtsstaat*, the "state of law," but more accurately translated as the "constitutional state" (see Heuschling, 2002, for a comparison of the idea of the "rule of law" and of the *Rechtsstaat*, and Barber, 2010, for a defense of the concept within contemporary legal theory). The word *Rechtsstaat* was a neologism coined in 1798 by J.W. Petersen (1758–1815).[22] The term was popularized by Carl Theodor Welcker (1790–1869) and, in particular, by Robert von Mohl, 1799–1875) in his 1844 treatise *The Political Science according to the Principles of the Constitutional State* (my translation, in German: *Die Polizei-Wissenschaft nach den Grundsätzen des Rechtsstaates*). For its proponents, the *Rechtsstaat* was a Kantian ideal: a commonwealth of free citizens guided by reason. The respect for fundamental rights and republican self-government was inherent in the idea of the *Rechtsstaat*. When, in 1883, in a letter to one of his ministers, Otto von Bismarck disparaged the whole idea of the *Rechtsstaat*, the Iron Chancellor understood what he was dealing with (Heuschling, 2002, p. 6).

But Bismarck could have saved his energy. Mirroring the declining fortunes of German classical liberalism after 1848 (when, as A.J.P. Taylor, 1945, famously said, "German history reached its turning-point and failed to turn"), the original conception of the *Rechtsstaat* began to mutate into a formalistic essence. The process started with Friedrich Julius Stalh (1802–1861) and continued with Otto Bähr (1817–1895), Otto Mayer (1846–1924), and Georg Jellinek (1851–1911). The metamorphosis was completed with the research agenda of the pure theory of law (*Reine Rechtslehre*) of Hans Kelsen, 1881–1973). For a generation of German jurists, the *Rechtsstaat* was just well-organized administrative law. Kelsen argued that any substantive commitment of the rule of law was a fanciful chimera (Kelsen, 1967).[23] There is no more overwhelming evidence of how high the tide of the positivist tradition reached than Hayek's formalist understanding of the "rule of law" in part II of the *The Constitution of Liberty*.

6.3. The Progressive Movement, Wilson, and the rule of law

Woodrow Wilson forcefully combined these two intellectual developments: the sovereignty of the legislature and administrative law as the only content of the "rule of law." Before becoming the 28th president, Wilson wrote *Congressional Government* (1885), a book that praised British parliamentary sovereignty as a superior alternative to the checks and balances of our Constitution. In other words, Wilson wanted to abandon the ideas behind the English constitution of the 17th century for which the Revolutionary War had been fought in favor of the ideas of the British constitution of the 18th century, which had been defeated at Yorktown. Simultaneously, Wilson pushed for the construction of an administrative state explicitly based on the Prussian template (Hamburger, 2014). Wilson represented the powerful intellectual force of progressivism and modern social science that facilitated the takeover of the "rule of law" by thin interpretations.

And those thin interpretations helped to open the doors to the modern administrative state and to the constitutional revolution of 1937. Starting in the 1920s and culminating with the New Deal, basic economic freedoms were severely curtailed even while formal requirements (such as due process) were largely still enforced (Ernst, 2014).

7. Rebuilding the limits to government

The poor performance of advanced economies in terms of productivity growth over the last 15 years is a warning that economic growth is not automatic. Any economist would recognize that many factors are behind this poor performance, from aging of the population to misguided fiscal and monetary policies. However, the overreaching expansion of the administrative state and increased uncertainty about regulation are a considerable dragging force. As a revealing anecdote, the Minnesota state government has decided, in its infinite wisdom, that interior decorators need a license.[24]

Not only has the thin understanding of the "rule of law" not been able to slow down the march of the administrative state, but it is itself at risk of being dissolved by the new institutions it helped unleash in the first half of the 20th century. An administrative state that regulates the minutiae of economic life is a state that cannot

[19] Perhaps this explains the vitriolic denunciation of George III in the Declaration of Independence, clearly out of proportion to any fault of the British king, and the absence of any reference to the Parliament (except an elliptical naming of "others"). Since the colonials did not recognize their links to Westminster, they did not have to "declare the causes which impel them to the separation" with respect to it.

[20] As Abraham Lincoln put it: "[I] never read anything which so profoundly interested and thrilled me." Quoted in Ogden (1932), p. 328.

[21] In the United Kingdom, parliamentary sovereignty was the background behind Jeremy Bentham's and John Austin's development of the view of the law as a command issued by the sovereign regardless of any substantive content. Perhaps this explains why the thin interpretation of the "rule of law" became the dominant one among analytic legal theorists.

[22] Petersen wrote under the pseudonym *Placidus* in his 1798 work *Literature on the Theory of State* (*Litteratur der Staatslehre*).

[23] This strict formalism reached sub-realistic tones with expressions such as the "national-socialist German constitutional state" (*Nationalsozialistischer deutscher Rechtsstaat*) or the "German constitutional state Adolf Hitler" (*deutsche Rechtsstaat Adolf Hitlers*) used between 1933 and 1945 by jurists such as Hans Frank and Carl Schmitt. Once the substantive commitments of the *Rechtsstaat* were eliminated, Frank and Schmitt did not find it particularly troublesome to eliminate the formal commitments, as well. All that was left was adherence to the desires of the leader.

[24] According to Kleiner and Krueger (2013), 35% of employees in the U.S. are now either licensed or certified by the government. Having lived five years in Minneapolis, I can testify that civilized decorating trends have made only minor inroads in the Upper Midwest. I fail, however, to see why it should be the role of the government to protect sturdy Minnesotans from poor color pairings in their living rooms.

live without arbitrary actions.[25] Legislative bodies lack the time or expertise to act beyond enacting broad guidelines. Judges, not entirely without reason, prefer to take refuge in Chevron deference or similar doctrines that exist in other countries. Even administrative agencies end up overwhelmed by their hubris. The Dodd-Frank Act's creation of the Consumer Financial Protection Bureau is not an accident: it is the unavoidable consequence of the structures laid down for decades. A group of unelected regulators, shielded from Congress and most judicial review, are deciding, based only on vague mandates, the conditions under which I can take out a mortgage. And deferred prosecution agreements make a mockery of centuries-old criminal law principles.

Recovering the original understanding of the "rule of law" is, therefore, not just an axiological commitment (as important as this might be), it is also required to protect self-government and prosperity.

An example of the potential benefits of restoring this thick understanding comes, paradoxically, from Germany, the intellectual source of many of our current problems. After the trauma of 1945, the Basic Law for the Federal Republic of Germany (*Grundgesetz*) and its Federal Constitutional Court (*Bundesverfassungsgericht*) embraced a much thicker concept of the "rule of law."[26]

Perhaps the most renown part of that understanding is Article 79(3) of the *Grundgesetz*, which establishes an eternity clause (*Ewigkeitsklausel*) limiting the substantive content of the changes to the norm[27]:

> Amendments to this Basic Law affecting the division of the Federation into Länder, their participation on principle in the legislative process, or the principles laid down in Articles 1 and 20 shall be inadmissible.

For our exposition, the relevant words are the eternal protection of the principles of Article 1 (human dignity, human rights, and the legally binding force of basic rights) and Article 20 (democracy, the federal structure of the state, people's sovereignty, right of resistance, and the protection of the natural foundations of life and animals).[28] This eternity clause was created to avoid paths to dictatorship that respected the formal requirements of the "rule of law," an event that Germany had witnessed with the passing of the Enabling Act (*Ermächtigungsgesetz*) on March 24, 1933.

But despite the fame of Article 79(3), I have always been more intrigued by Article 80 of the Basic Law and the tight controls it imposes on the regulatory activity of the administrative state and by a number of decisions vigorously defending the property rights protected by Article 14(1) against excessive taxation.[29]

Furthermore, the ideas of ordoliberalism, a movement that integrated jurists and economists, became mainstream in Germany. Ordoliberalism emphasizes rules and the importance of following constitutional arrangements, both in law and in economic policy.[30] Even the whole European Union project, with its view of integrating economies through law and rules but always respecting fundamental rights, is a peculiar proof of this renewed thick interpretation.

Perhaps these factors explain why, among all major continental European countries, Germany is still the most market-friendly economy, why Germany has defended (although often more in words than in deeds) the strong adherence to rules as the only way forward in managing the euro crisis, and why the Federal Constitutional Court has been the only entity in the whole of Europe that has dared to ask where the Union is going in terms of the "rule of law."

None of the previous observations are motives for undue celebration: limited government is on retreat all over Europe. Even stating that rules may be better than discretion while conducting monetary policy has become a sign of eccentricity (if done under the guise of respectable academic language) or pure madness (if more direct words are preferred). But they are, at least, a sign that the "rule of law" can work, even in a country with such a troubled history as Germany.

8. Concluding remarks

I started this paper quoting Theodore Plucknett. It seems a proper Wagnerian leitmotif to return to the English historian for our conclusion:

> the mediaeval man was above all a man of action, and out of the night of the dark ages he began to build the fabric of law. To him the rule of law was not only a worthy achievement of the spirit, but also a great active crusade, and the greatest of all the crusades, because it alone survived its defeats.

Nowadays, it is fashionable to write monographs exploring the rise of the West versus the rest. The list of theories accounting for the great divergence is large: from imperialism and the plundering of natural resources (from one side of the aisle) to superior institutions (on the other side). However, even among those defending the role of institutions, there is little appreciation of the pivotal role played by law in European development.

Ningzong, the Chinese emperor in 1215, was secure in his large kingdom and had ample sources of revenue. He had numerous counselors and he regularly asked for their advice, but he would never need to call representatives of his realm and request their approval to raise taxes or engage in war. Simply put: he would have not even understood what a charter such as *Magna Carta* was. In comparison, John of England and the other European territorial rulers had to deal with parliaments, lawyers, the Catholic Church, the nobility, and self-governing cities. And as the success of *Magna Carta* shows, these counterbalancing powers often won. In China, there was never anything remotely similar to parliaments, law was not conceptualized as an autonomous area, there was no

[25] In fact, I would argue that only as time passes by and the old memories of the traditional "rule of law" disappear, would we start suffering the real, long-run consequences of the administrative state.

[26] See Collins (2015). After the end of the war, there was a parallel renewal of interest in Natural Law among German jurists and a rejection, by many, of the strict positivist positions of Kelsen and his followers. The conversion of Gustav Radbruch, 1878–1949) from the Weimar Republic's positivism to the Federal Republic's iusnaturalism is a transparent example (see Radbruch, 2003). The analysis of this renewal is, unfortunately, beyond the scope of this paper.

[27] The official translation of the Basic Law into English can be found at https://www.btg-bestellservice.de/pdf/80201000.pdf.

[28] The Federal Constitutional Court, in its decisions, has added mentions of justice and moral law (see Kommers and Miller, 2012, loc. 1500). Article 146 of the *Grundgesetz* establishes, nevertheless, that the Basic Law, which despite its nearly 70 years of life was conceived as a transitory text never approved by a plebiscite, "shall cease to apply on the day on which a constitution freely adopted by the German people takes effect." Could this new constitution eliminate the eternity clause or the principles protected by it?

[29] See, for example, the decision of June 22, 1995, BVerfG-Beschlu(2 BvL 37/91) BStBl. 1995 II S. 655, limiting the total amount of taxation that a person could endure from an income and a wealth tax to 50% of income (I am skipping a number of nuances in the decision). A significant choice was to locate the Federal Constitutional Court in Karlsruhe, a mid-size town in Baden-Württemberg, far away from the centers of political and economic power in Germany. One has the suspicion that our own Supreme Court is unduly influenced by Washington life. I often wonder whether a Supreme Court Justice located in Omaha or Des Moines would not be interested more in constitutional matters and less in the opinion pages of the *New York Times* or in keeping a good standing in the cocktail party circuit of Georgetown.

[30] Many first-generation ordoliberals, such as Franz Böhm (1895–1977), Walter Eucken (1891–1950), and Ludwig Erhard (1897–1977) were associated with the Freiburg School. Others, such as Wilhelm Röpke (1899–1966) and Alexander Röstow (1885–1963), were more independent. There are deep affinities between ordoliberals and James Buchanan's project of constitutional economics. See Buchanan (1986).

independent and organized religious organization (the Buddhist temples were far from being a coordinated source of power), the nobility had been largely replaced by a cadre of civil servants selected by an examination system, and cities existed only to the extent that the emperor found it advisable.

Magna Carta and its influence on the history of the English-speaking nations is overwhelming evidence that Europe was different. As Plucknett reminds us, the Middle Ages changed the course of European history and Europe's offshoots in North America and Oceania forever. The supremacy of the law was the secret weapon of Europeans.

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A More or Less Perfect Union

A Personal Exploration by Judge Douglas Ginsburg

"The Congress shall have Power

. . .

To regulate Commerce . . .

among the several States . . . ."

Art. 1 § 8, cl. 3

"[E]ven if appellee's activity be local and though it may not be regarded as commerce, it may still, whatever its nature, be reached by Congress if it exerts a substantial economic effect on interstate commerce and this irrespective of whether such effect is what might at some earlier time have been defined as 'direct' or 'indirect.'"

Wickard v. Filburn, 317 U.S. 111, 125 (1942)

The Congress shall have Power

. . .

To regulate matters substantially affecting Commerce

. . .

among the several states . . . .

“nor shall private property be taken

for public use,

without just compensation.”

"Accordingly, when this Court began applying the Fifth Amendment to the States at the close of the 19th century, it embraced the broader and more natural interpretation of public use as 'public purpose.'"

Kelo v. City of New London, Conn., 545 U.S. 469, 479–80 (2005).

"Because [the City's economic development] plan unquestionably serves a public purpose, the takings challenged here satisfy the public use requirement of the Fifth Amendment."

Kelo v. City of New London, Conn., 545 U.S. 469, 484 (2005).

The Takings Clause as Revised

nor shall private property be taken for

~~public use~~ a public purpose,

including economic development,

without just compensation.

5th Amendment (1791): “No person shall . . . be deprived of life, liberty, or property [by the federal government], without due process of law.”

14th Amendment (1868): “. . . nor shall any State deprive any person of life, liberty, or property, without due process of law.”

“. . . nor shall any State deprive any person of life, liberty, or property, without substantive or procedural due process of law.”

Procedural due process: redundant; process *is* procedural.

Substantive due process: without a textual foundation? “Lex terrae” in Magna Carta?

<u>Lochner era, 1897–1937</u>: substantive due process used to hold unconstitutional state and federal laws restricting economic liberty or private contract rights.

Examples: federal regulation of child labor; state pension law.

<u>Revival, 1965–present</u>: substantive due process used to hold unconstitutional laws that restrict privacy.

Examples: married couples' access to birth control products; access to abortion; private homosexual acts.

The Ninth Amendment

"The enumeration in the Constitution, of certain rights, shall not be construed to deny or disparage others retained by the people."

Where are those other rights to be found?

- **Natural Law, for the "unalienable rights" with which all men "are endowed by their Creator" . . . per the Declaration of Independence?**
- **Common law, for the rights of Englishmen as of 1789?**
- **A continuing common law of the Constitution?**


A More or Less
Perfect Union
A Personal Exploration by Judge Douglas Ginsburg
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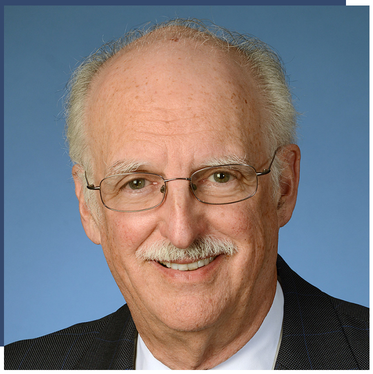

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Douglas H. Ginsburg is a judge of the US Court of Appeals for the District of Columbia Circuit, to which he was appointed by President Reagan in 1986. He is also a professor at the Antonin Scalia Law School, George Mason University, where he teaches courses in antitrust and jurisprudence, and a visiting professor at University College London, Faculty of Laws. Before joining the bench, he was a professor at Harvard Law School and then assistant attorney general of the United States for antitrust. Judge Ginsburg is a graduate of Cornell University (1970) and of the University of Chicago Law School (1973).

Ginsburg serves on the advisory boards of many journals and academic centers, including the *Supreme Court Economic Review*, the *Harvard Journal of Law and Public Policy*, the *University of Chicago Law Review*, and, at University College London, both the Centre for Law, Economics and Society and the Jevons Institute for Competition Law and Economics.

Ginsburg is the author or coauthor of many books and articles, including "Originalism and Economic Analysis: Two Case Studies of Consistency and Coherence in Supreme Court Decision Making," (*Harvard Journal of Law and Public Policy*, 2010); and "On Constitutionalism," (2003 Simon Lecture, *CATO Supreme Court Review*, 2002–03). Judge Ginsburg recently completed a three-part series on the Constitution, *A More or Less Perfect Union*, to be broadcast on PBS stations early in 2020.

The rise and fall of environmental socialism: Smashing the watermelon[1]

Jeff Bennett[2]

1. *The bad news*

The green gravy train is fully loaded and achieving record speeds. Rent seekers of many different varieties have taken their seats and are enjoying the largess created by the fears of environmental doom and gloom.

The current season of bush fires in Australia illustrates the point.

The motivating hypothesis for the fear is that climate change is causing earlier and more severe bushfires. Hence this season's experience (with declarations of 'catastrophic' conditions being made for the first time ever followed by reports of 'unprecedented' damage) will be 'the new normal'. Who gets the gravy once on board?

1. The politicians – who can achieve photo opportunities amidst fire ravaged communities and make announcements about immediate support for those impacted and long term interventions to address climate change.
2. The firefighting bureaucrats – who lobby for more equipment and more staff to deal with the climate change 'emergency'.
3. The press – who get to present reports from areas that look like war zones without being shot at.
4. The scientists – who argue for more research funding to understand better (for example) the impacts of climate change on fire behaviour.
5. The green industrialists – who gain from subsidies paid to encourage the transition to a 'de-carbonised' economy.
6. The 'environmentalists' – who are more able to assert control over their not-so-convinced fellow citizens in achieving their goal of stopping any new coal mining in Australia.

It's hard to find any 'baptists' in this list of 'bootleggers'[3]. Perhaps there are some genuine environmentalists who believe fundamentally that anthropogenic climate change constitutes an 'emergency' and that interventions by the state internationally is capable of addressing it. However, the hypocrisy of those espousing to be truly green tells a different story. Whether it's Leonard di Caprio, Prince Harry, Al Gore or even David Attenborough, all jet-setters of renown, all seem to have a lot to gain in fame and/or fortune from promulgating the climate change catastrophe. Even those who appear at first glance to be 'baptists' (such as the weeping children on strike from school, who

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[1] Invited paper presented at the 2020 Special Meeting of the Mont Pelerin Society, Hoover Institution.

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[3] Yandle, B. (1983). "Bootleggers and Baptists: the education of a regulatory economist". *Regulation*. 7 (3): 12–16. Yandle used the example of the prohibition era 'coalition' between those who believed that alcohol was the root of all evil and those who made a lot of money from the resultant black market in booze to establish the more general relationship between rent seekers and those who are genuinely well-meaning.

fear the imminent collapse of the planet as we know it, or the outraged St Greta of Thunbergs of the world) seem to have been converted to their religion by the bootleggers.

The most concerning aspect of the list of bootleggers is the proportion of them who see their ride on the climate change gravy train as a means of asserting state control over the actions of others. These are the "watermelons": those with an outwardly green appearance but who are at their core, socialists. And in the context of climate change, many of these are international socialists who aim for one-world governance. To use another metaphor, the socialist wolf is now dressed in green clothing.

2. The good news

In the face of the doom and gloom narrative that is promulgated by the environmental rent seekers, there is clear evidence that things aren't so bad after all. The work of Lomborg[4] and Ridley[5] stand out in this regard. The evidence includes 'macro' level indicators of human welfare being enhanced by such fundamental measures as lower infant mortality and increasing life expectancy and 'micro' indicators of improving environmental conditions such as first world water and air quality. Deaths worldwide from natural disasters have fallen from 453 per million people in the 1930's to 10 per million in the 2010's[6].

The so-claimed 'unprecedented' damage caused by this season's bushfires in Australia has been eclipsed numerous times over the last century[7]. The formal declarations of 'catastrophic' conditions were indeed the first ever made, but only because that category was established ten years ago as a sub-division of the previous 'extreme' category.

The forecasts of 'disastrously' rising temperatures and thence sea levels along with the broaching of 'tipping points' have not eventuated, with climate model after climate model failing to be validated by experience. Now many climate change scientists are more guarded in their predictions. The most recent alarmist paper in Nature[8] is prolific with the words 'might' and 'could' alongside calls for more research funding into tipping points. However, that caution is not reflected in their calls for action. The imperative then appears without the 'if': 'warming must be limited to 1.5 °C. This requires an emergency response'.

However, at least one alarmist prediction has proven correct. To quote the late and wonderfully erudite and witty Clive James[9]:

'In his acceptance speech at the 2008 Democratic convention, Obama said – and I truly wish this was an inaccurate paraphrase – that people should vote for him if they wanted to stop the ocean rising. He got elected, and it didn't rise'. (p322).

Obama's predictive capacity was not apparent in his concerns regarding the Great Barrier Reef. Those concerns have been expressed over and over again for at least the last 40 years, most notably and recently in the Great Barrier Reef series by Sir David Attenborough[10] who has predicted that 'the

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[4] Lomborg, B. (1998). The Sceptical Environmentalist, Cambridge University Press.
[5] Ridley, M. (2010). The Rational Optimist, Harper.
[6] https://www.gapminder.org/topics/natural-disasters/
[7] See Bennett, J. (2012). "Private and Public Provision of Fire-fighting Services in Rural Australia" in Bradshaw, K. and D. Lueck, Wildfire Policy: Law and Economics Perspectives, New York: Resources for the Future Press.
[8] Lenton, T. *et al* (2019). "Climate tipping points — too risky to bet against" Nature. https://www.nature.com/articles/d41586-019-03595-0
[9] James, C. (2017). "Mass Death Dies Hard" in Marohasy, J. Climate Change: The Facts. Connor Court Publishing
[10] https://www.abc.net.au/tv/programs/david-attenboroughs-great-barrier-reef/

reef will be dead by 2100' due to acidification of the oceans which in turn results from the release of carbon dioxide in the burning of fossil fuels. Yet the reef lives on, with tourism operators on the reef wringing their hands more and more as climate alarmists report more and more climate-induced coral bleaching events without explaining that the cycle of life on a coral reef involves death and re-birth.

3. Forces to harness

Despite the evidence of unfulfilled doomsday forecasts, even going back to the famed Ehrlich-Simon[11] wager, the forecasts of environmental catastrophe continue and the push toward environmental socialism marches on. Indeed the cries of imminent global demise (along with the persecution of anyone challenging the claims) have become even shriller. Last year saw the promulgation of the Climate Emergency tag by the Extinction Rebellion putsch. It seemed that the previous level of alarmism had yielded insufficient gravy, particularly in Australia where a federal election saw the rejection of higher greenhouse gas reduction targets and the approval of a major new coal development.

But it is apparent that the gravy train will not be readily halted, not just on climate change, but on the full raft of environmental issues. Many nations of the developed world have already forsaken elements of their democratic self-government by signing onto United Nations treaties including the Paris Agreement within the United Nations Framework Convention on Climate Change, the Convention on Biological Diversity, the Basel Convention on the Control of Transboundary Movements of Hazardous Wastes and the Convention on International Trade in Endangered Species of Wild Fauna and Flora (CITES).

Are there any forces that can be used to act as a brake on the environmental gravy train's progress toward socialist world governance or even put it into reverse? Two at least are evident.

The first is wealth. For instance, Kahn[12] demonstrates that nations with greater wealth and democratic institutions suffer less damage from natural disasters. Being wealthy is the best way to cope with environmental damage. More generally, the Kuznets Curve[13] has been shown to apply to environmental issues such as air and water pollution: Beyond a threshold, increasing income is correlated with improving environmental health. Wealth better enables the development of solutions to environmental problems as well as the means of protecting against them. Hence the implication is that with greater wealth and better environmental conditions, more and more apocalyptic predictions will be demonstrated to be false. The evidence to support those on the gravy train will be diminished.

The second force is the power of the market. It is apparent to MPS members that the growth in wealth required to see the Kuznets Curve deliver improved environmental conditions is dependent on the operation of free markets in an institutional setting that establishes the rule of law, particularly relating to the definition and defence of private property rights. However, the importance of well-defined and defended property rights goes deeper. The further the property rights regime can be extended to cover resources that are conventionally regarded as producing

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[11] https://www.spiked-online.com/2015/09/29/the-simon-ehrlich-wager-25-years-on/

[12] Kahn, M. (2005). 'The Death Toll from Natural Disasters: The Role of Income, Geography, and Institutions', Review of Economics and Statistics 87(2): 271-284.

[13] See Chapter 5 'Trade and the Environment' in Bennett, J. (2012). Little Green Lies: An expose of twelve environmental myths, Connor Court Publishing.

public goods and services, the more the discipline of the market can be asserted over those resources and the less the ill-disciplined, rent seeking, political process would be allowed to operate.

4. *Ideas for the future*

Given that conventionally, environmental goods and services have been seen by economists as 'public goods' that are subject to 'market failure' and hence necessitate government intervention, what can change in the future? The declaration of public good status usually involves a recognition that property rights are too difficult to define and defend. In other words, the transaction costs involved in establishing trade overwhelm any benefits that can be enjoyed through the mutually advantageous exchange of property rights.

However, that thinking ignores the development of technologies that can lower the costs of defining and defending property rights. Information about the relative strengths of people's preferences, which is the key to the exchange process, is increasingly available at lower costs. As marketers are able to use social media and web profiles to delve deeper and deeper into the possibilities of establishing markets for previously ill-defined rights, the environment will become more and more available as a new frontier for exchange. Advances in collecting data, data storage and data analytics mean lower information costs. Advances such as block-chain provide cheaper and more trustworthy definitions of property rights ownership.

And rights need not be defined as private to a single entity. The emergence of exchange in club good space is also likely to accelerate. Lower transaction costs and greater information will increase the trust held between individuals who cooperate as a group to manage environmental resources and to exclude those who don't pay for using those resources.

The implication of the advance in technology is that markets will be able to satisfy interested parties with what they want from the environment better than a frustratingly slow and ineffective public sector. With a financial opportunity presenting itself through the environment, an incentive will be apparent for all parties[14].

Despite the strength of these forces to stand against the tide of environmental socialism, numerous challenges remain.

Wealth is a two edged sword. While increased wealth has its environmental ups, it seemingly creates a growth in the proportion of the populace who are not only environmentally aware but who see the government as the solution to their problems. The Extinction Rebellion movement is a phenomena found in developed western nations, not in the less developed world.

More importantly, even though markets may be able to form with technological advances in defining and defending property rights, they can be 'crowded out' by government action. For instance, if governments persist in declaring more state owned and operated national parks and nature reserves, the demand for private reserves will be satiated. And those with strong preferences for nature are likely to find it cheaper to lobby government for more reserves (so spreading the costs over the whole population) than buying shares in new private reserves. Likewise, it is likely to be cheaper for those with fears of imminent climate collapse to glue themselves to the pavement in an effort to stop coal mining than it would be for them to buy out the mineral leases.

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[14] See examples of actual and potential opportunities in Bennett, J. (2016). Protecting the Environment: Privately, World Scientific Press.

This means that governments will have to back off from environmental goods provision to allow the private sector to become increasingly established and prove itself to be more than competent. Achieving this will be difficult given that government itself fills the first few carriages of the gravy train.

Furthermore, those who gain from the promulgation of doom and gloom will not go away, even when their prophecies fail to eventuate. Paul Ehrlich still thrives on fear mongering, having moved from global cooling to global warming via global starvation.

The reality is that continually exposing the environmental myths to the blow torch of evidence will remain critical. So too will the encouragement afforded by experience in jurisdictions where government does step back from the primary owner and manager of resources providing environmental goods and services. It is only when that knowledge is widely disseminated will the green socialist gravy train be shunted into a siding.

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Bennett has a particular interest in private-sector initiatives to supply environmental goods and services, as reflected in his book *Protecting the Environment: Privately* (World Scientific Press). Most recently he published (with G. Scheufele) a book on the use of markets to protect biodiversity: *Buying and Selling the Environment: How to Design and Implement a PES Scheme* (Academic Press). Bennett is a member of the Biodiversity Conservation Advisory Panel of the NSW Government and the Social and Economic Advisory Board of Food Standards Australia and New Zealand. He consults for business and government clients and with his wife, Ngaire, operates a farm producing super-fine merino wool.

Understanding the left.

Comments for Mt Pelerin society meetings, "How to deal with the resurgence of socialism"
January 2020, Hoover Intistution

John H. Cochrane
Senior Fellow, Hoover Institution

A new wave of government expansion is cresting. It poses a deep threat not just to our economic well being, but to our freedom — social, political and economic freedom, and even to the basic structure of our government. Our session is titled "how to deal" with it, but I think it's better to understand what it is, first.

1. A will to power

Consider the economic agenda proposed by the Democratic presidential candidates:

-A government takeover of health care and abolition of the private market.
-Taxpayer bailout of student loans. Necessarily, after that, taxpayer funded college.
-An immense industrial-planning and regulation effort in the name of climate.
-Government jobs for all. "Basic income" transfers on top of social programs.
-Confiscatory wealth, income, estate and corporate taxation.
-Government and "stakeholder" control of corporate boards.
-Greatly expanded rent controls. The government pays all rent more than 30% of income. Public housing. Forcing builders to create much more government-allocated "affordable" housing.
-Government boards to set wages, hiring and firing. Restoring mandatory union membership, including support for union political activity.
-Extensive speech and content regulation on the internet.

And this is the *center*. I leave out the left wing of this movement, whose ideas seem quickly to migrate to the center.

Free-market economists, the few of us who remain, respond in the usual way. "I share your empathy, but consider all the disincentives and unintended consequences will doom these projects now, just as they have a hundred times before, and end up hurting the people you — we — want to help. Here is a set of free-market reforms that will actually achieve our common goals…"

But why say this for the 1001th time? Nobody's listening. We're making a big mistake: We are presuming a common goal to produce a free and prosperous society, full of opportunity for everyone, and somehow this crowd missed obvious lessons of history and logic. Let's not be so patronizing. If their *answers* are so different, it must be that they have a different *question* in mind. What is the *question* to which all this is a sensible, inevitable answer?

Ask that, and only one question makes sense. Power. All these measures gives great power those who control the government.

But what should happen, once this power is gained, if those deplorable morons vote in a Trump junior who uses this power to different ends and to reward different people? We can't have that, can we. The most important power is the power to stay in power, and these measures are ideally designed to that end too.

Stakeholders on boards and a federal charter? The purpose is explicit: Power for those who run the government to tell large corporations who to hire, who to fire, what to make, what to buy, how much to charge and pay. And power to demand those businesses' political support.

What happens when you put billionaires, their lawyers and lobbyists, congresspeople, and the IRS together for a once-a-year discussion of just how hideously complex financial structures will be valued, and how many millions the billionaires will consequently fork over? The wealth tax is explicitly advocated as a device to reduce the political power of billionaires to oppose those proposing it. The trade of political support for keeping some money is inevitable.

Why address climate with extensive regulations and government-run companies rather than a simple and much more effective carbon tax? Well, then those who run the government get to give out the jobs and contracts. Legal and regulatory woe already already befalls the business who does not support the effort.

Regulating the internet? It's just too obvious. He or she who can define and regulate "hate speech" and "fact check" political speech, has enormous power to win elections.

Consider the associated political agenda

-Stacking the Supreme Court.
-Eliminating the electoral college.
-Eliminating the filibuster.
-Detailed federal control of elections.
-Even more government control of campaign finance.

Only grab-and-keep power makes sense of that.

2. The great awokening

It's a mistake to call this movement "socialism." That old name elevates it as a set of ideas, and misses its central and novel character as a movement.

This ideological side of this movement marshals the social, cultural, and political force of religious fanaticism. Do not expect such an ideology to be any more coherent, fact-based, or amenable to logical argument than those of the missionaries who alternate with the local activists in interrupting your dinner.

It starts with an all-encompassing narrative of sin, and guilt; of a vast conflict between good and evil people.

Western civilization is nothing more than the expression of systemic racism, sexism, colonialism, homophobia, and genocide. Our economy and political system are dominated by huge monopolistic corporations and billionaires, enriching themselves by squeezing the little people dry. Swarms of unemployed roam the land as if the 1930s never ended.

Armageddon is coming, in exactly 11 years[1]. Climate is the world's "greatest problem," never mind war, pandemic, civilizational collapse or the mundane smoke and bugs that kill thousands. But speak not of nuclear power, energy- and land-conserving genetically modified foods, carbon capture, geoengineering or mild adaptation — only atonement for carbon sins will do. How should California bring the rains, or stop the fires? Of course, build a high speed train. Build no dam, clear no wood. That would not atone for our sins.

The IPCC tells us that *as a scientific fact*, climate projects must "increase gender and social inequality… [promote] sustainable development… [address] poverty eradication" and "reduce inequalities." Science, not politics, proclaims that "social justice and equity are core aspect… to limit global warming to 1.50ºc."

If we are really in a civilization-ending ecological crisis, maybe some of the other agenda could wait? The Green New Deal offers an even more extreme linkage.

A new "eco-authoritarian" or "coercive green new deal" movement takes apocalyptic language to a far more logical conclusion. If indeed civilization is going to end in 11 years, we can't sit around and wait for democracy to wake up. "Dissenters" must be "silenced" and those unwilling to go along "thrown overboard." A "*distinctly non-Republican Congress*" must "coerce a range of powerful interests (coal companies, oil and gas corporations, auto manufacturers, the Pentagon, and so on) to fall into line." These are quotes.[2]

I'm no climate denier. I favor a carbon tax, nuclear, adaptation, lots of R&D, the standard market-based technocratic solutions to environmental problems. But by tying climate policy to this extreme power-grab, and its society-and economy-upending agenda, those who resist the rest of the agenda cannot help productively help the climate.

But you can be redeemed from sin through professions of faith, and participation in the great religious war.

To gain and signal virtue, one must master an ever-changing menagerie of nonsense words, repeated over and over until they gain meaning. Say no longer global warming, not even climate change, now say "climate catastrophe." Say not poor neighborhood, say "marginalized" and "underresourced" "community." Say not homeless, say "unhoused." Say not "minority," you must say "minoritized." All verbs are passivized, — use your imagination to fill in the dark subjects. "Violence," "trauma" and "racism" are thrown out like candies, trivializing centuries of suffering.

You can even buy indulgences. After you fly your private jet to the climate conference, buy carbon offsets. Don't look too hard, as they do not actually offset any carbon.

A politico-religious cult is a powerful force. It appeals to all the people in our secular society who once would have gone to do missionary work, who need the sense of meaning in their lives that such efforts gave. Now they activate for "social change," which means to demand government power. It usefully demonizes opposition, cutting off the usual civic, scientific, or scholarly debate. Opponents are not our fellow citizens, to be convinced or compromised with.They are evil, they must be squashed. This is the force of the protestant reformation, of Soviet communism, of Islamic Jihad.

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[1] I'm quoting Jane Fonda here, who in a recent NPR interview pointed out correctly that if the tipping point was 12 years in the future last year, it is 11 years out now.

[2] John Feffer https://www.thenation.com/article/china-coercive-green-new-deal/

This movement has taken over the institutions of our society. It pervades the schools and universities, nonprofits, the media, international organizations, and the Federal bureaucracy, what political scientists call the "elites." Conservatives are social outcasts, and know to keep silent.

For this reason, I think we have the most to fear from this movement on the left. As a libertarian, representing a solid 3% of the electorate, I try to point out the shortcomings of both US political parties. And indeed the left has been nearly hysterical for three years about "autocracy," "fascism," "threats to democracy" "undermining the constitution," and so on.

But it's hard to see any comparable, durable threat on the right. Trumpism consists of the rambling impulses of one man - which, yes, often step over traditional norms and restraints. Trumpism has no reservoir of ideas, no organized ideology going back a century, no similar corralling of the forces of the state and private institutions to its cause. Trumps will blow away as soon as that one man is gone.

Indeed, the right has been fighting a slow retreat since Reagan, its ideas only "bring us progressivism, but not so fast," its tactics largely tit for tat, and its successes, such as recent judicial appointments, measured only by its ability to slow progressivism down. The political right in America has no new ideas, organization, will to power, or representation in America's elite institutions. (With the possible exception of the military, police, and firefighters!)

This movement still represents a minority of Americans. But small well-organized political-religious cults have taken over countries in the past, especially when the people in charge of a society's central institutions have lost faith in their purpose. See Chile

The current election is not really about who will be President. It is really about how deeply the new progressives will take over the Democratic party. Either way, this is a movement so deeply rooted, and so all consuming to those in its grasp, that it will be with us for decades.

3. Partisanship and polarization

This is all the more dangerous because of the steady erosion of our framework of government — formal checks and balances but more importantly informal norms, restraints, rules of behavior. Each issue is now a scorched-earth battle — never mind that sooner or later they will do unto you as you do now unto them, and worse.

Lots of commenters puzzle at this partisanship. Maybe it's twitter. The parties usually answer as children in a playground, "Timmy did it first." I prefer a little economics: Ask *why* people are *choosing* to violate norms, despite a half century's experience of the destructive consequences?

Once asked, the answer to that question too is pretty obvious: The more you play a winner-take-all game, the more winning this battle is all important, and long-run consequences be damned.

Our government is not designed as a democracy. We are designed as a republic, with rights and protections for electoral minorities. A 51% majority cannot take power, shove anything down the opponent's throats, and rewrite the election rules to stay in power.

Why not? Because If we become that, then the 49% will use any means to avoid losing. America must remain a country in which a politician, a party, an interest group, can afford to lose an election; surrender power, regroup and try again.

But the expansion of Federal power, the expansion of executive power, the unintended consequences of “democratic” (small D) reforms, the greater political role of the judiciary, and each side’s inability to trust the opponents to follow usual norms and restraints are all turning American government to a winner-take all game.

And, one of the many strategies in a winner-take all battle is to ally with a religious cult. We see that throughout the war-torn rest of the world.

What do I mean by norms? Consider a few increasingly quaint rules of political etiquette that are quickly vanishing.

- Presidents should do not routinely use executive orders, regulations far beyond statutory authority, or dear colleague letters to advance a policy agenda. Presidents don’t declare national emergencies to get their way on small policy issues like tariffs and border wall funding.

Tit will lead to tat. Berinie Sanders and Alexandria Ocasio-Cortez have already called for declaring climate a national emergency. “National emergency” has an appropriately chilling tone, as it means suspension of the normal democratic process.

- We don’t decide major issues by one-vote margin, party-line votes, by executive orders, or by 5-4 Supreme Court cases.

Social security, medicare, and medicaid passed with large Republican cooperation. The 1986 tax reform passed nearly unanimously. That a process of long discussion and negotiation produced buy-in also gave both sides reassurance that decisions of this magnitude do not depend on squeaking by the next election, or appointing one justice.

- Presidents get their nominees approved in most cases. Confirmation centers on policy and action, not on personal destruction.

Supreme Court nominations have descended into madness. Lower level appointments are beginning to inherit the same passion.

Why? The courts are deciding big policy and political issues, and allow winner-take-all, shove-it-down-their-throats policy-making. The specter that a 5-4 decision can decide abortion law for the whole country is a huge part of the norm-breaking in court appointments.

- You don’t question the legitimacy of elections. Get over it, win the next one, don’t tear the country apart.

- You don’t use impeachment as a regular part of the political process.

Be sure a Republican House will start impeachment investigations the minute President Warren is elected, and will start by subpoenaing her Harvard job application and every other private record of her life to try to embarrass her. Impeachment of Supreme court Justices is already on the table.

- You don’t use the criminal justice system or investigations to take down political opponents.

- Don't persecute losers.

In many countries, losing an election means that the "justice" system quickly closes in, and you lose your property, your business, your liberty, and sometimes your life.

When you can't afford to lose an election, politicians in power make darn sure not to lose elections. Norms of losing gracefully, of refraining from using the full powers of the police, justice, tax, regulatory authorities to stay in power, of not declaring national emergencies, of not challenging elections, and, in the inevitable end, not resorting to force, will not survive.

President Trump's "Lock her up" chant, deserved or not, was immensely destructive. Trump may reap abundantly. After Trump leaves power, the endless investigations into his finances and business dealings, will dog him and likely impoverish him.

4. What to do?

To get out of this we must solve the winner-take-all rules of our political game. Despite its dysfunction, it strikes me that pulling power back to congress from the administration, its agencies, and the judiciary is a useful step.

In foreign conflicts, in marriage counseling, and in kindergartens, we recommend small "trust building" steps. Alas, trust is hard to rebuild and easily destroyed. It will take a long time.

I get the sense that in previous eras, our forebears, while equally if not more acrimonious on policies, by and large put continuation of the system at a higher priority — with one immense tragic exception. I also sense they thought it more fragile than we do. Perhaps Americans are too lulled in confidence that our exquisite constitutional order will survive, no matter how many norms are broken. Perhaps a greater fear that one more egregious violation of norms will lead to the collapse of the whole system might be useful. Perhaps, however the woke cult's disparagement of our system of government leads too many not to think it worth saving.

And hope for the renaissance of freedom, of the desired by most in this room? Well, that's a long way off. Let's make sure we're here to discuss it first.

5. Conclusion

Our session is titled "how to deal with socialism," My talk has mostly been about how to understand the modern movement on the left. You have to understand something before dealing with it. Bottom line:

This isn't your grumpy uncle's socialism, singing Pete Seeger union songs from the 1930s. What is the question to which its goals are an answer? Only one makes sense, a political will to grab, expand, and keep the power of the federal government.

That political program is married to a new secular cult. That movement has already taken over most of the "elite" institutions of our country, and disarmed the rest, who now feel guilt rather than pride of and hope for the American project.

Politicians have chosen partisanship, and chosen to ally with this jihadist cult, because the expansion of government power has made our system much more winner-take-all and shove-it-down-throats of electoral minorities.

Fix that, I think, and our society survives. Misunderstand this at our peril

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Cochrane's recent publications include the book *Asset Pricing* and articles on such topics as dynamics in stock and bond markets, the volatility of exchange rates, the term structure of interest rates, the returns to venture capital, liquidity premiums in stock prices, the relation between stock prices and business cycles, and option pricing when investors can't perfectly hedge. His monetary economics publications include articles on the relationship between deficits and inflation, the effects of monetary policy, and the fiscal theory of the price level. He has also written articles on macroeconomics, health insurance, time-series econometrics, financial regulation, and other topics.

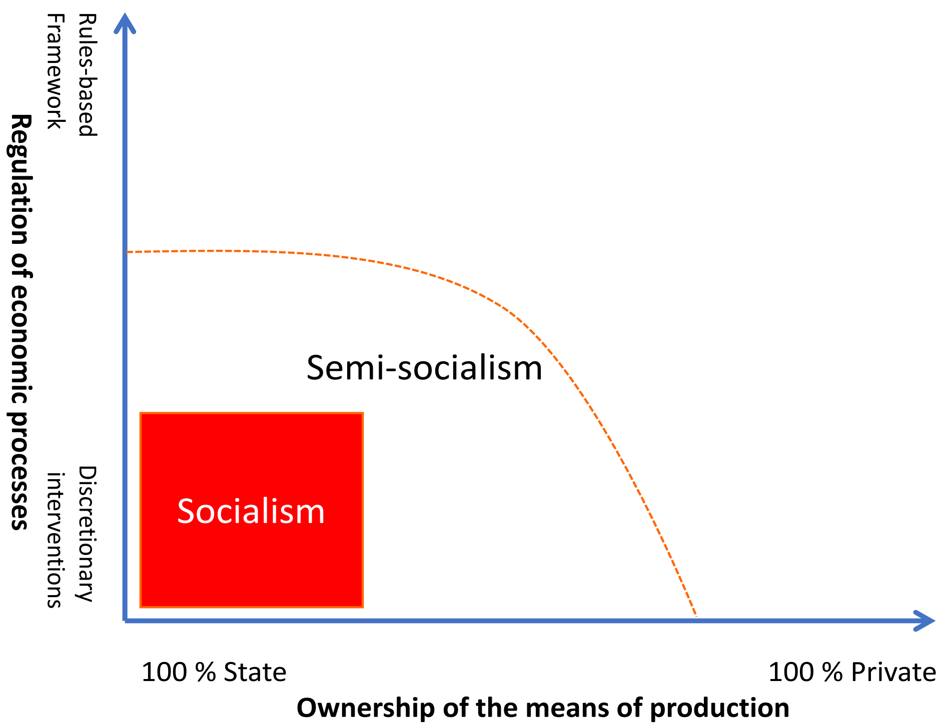
Cochrane was a coauthor of *The Squam Lake Report*. His PhD class on asset pricing is available online via Coursera. Cochrane frequently contributes editorial opinion essays to the *Wall Street Journal*, *The Hill*, and other publications. He maintains the *Grumpy Economist* blog. Cochrane earned a bachelor's degree in physics at MIT and his PhD in economics at the University of California–Berkeley.

Economic systems between socialism and liberalism and the new threats of neo-interventionism

Lars Peder Nordbakken

Civita

The economic concept of socialism

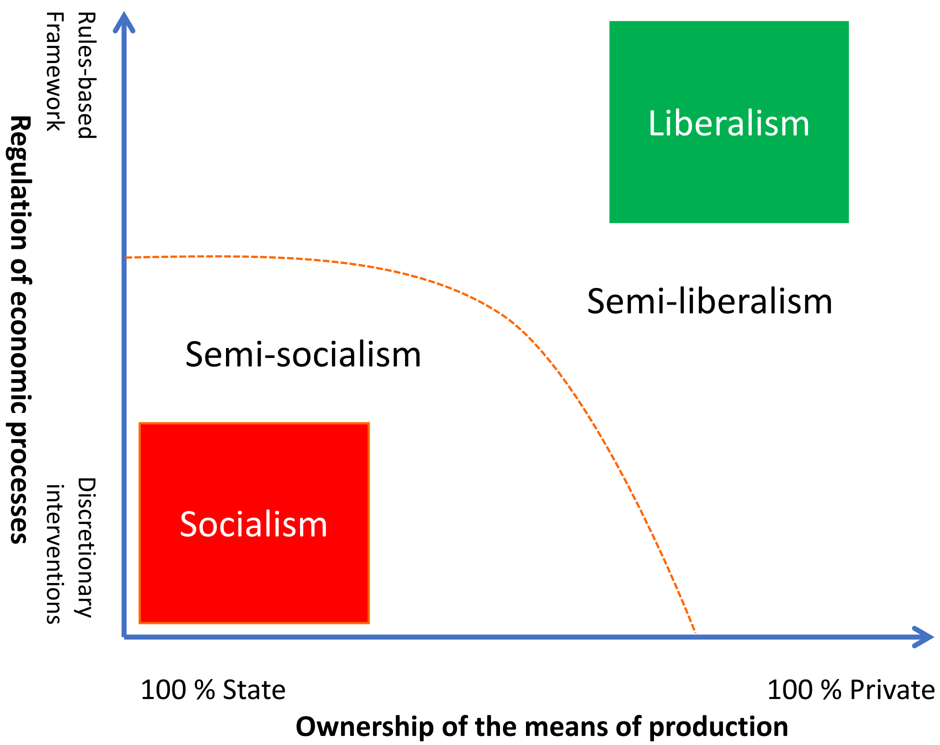


«The concept of socialism is a controversial one. Disputes have, and presumably always will, rage as to what shall be understood by socialism and as to how the socialist society shall be organized. There are, however, two main criteria for socialism which are generally accepted in scientific discussions: **that the State owns the means of production, and the State controls industrial life.»**

Trygve J. B. Hoff

Economic Calculation in the Socialist Society,1949 (1938)

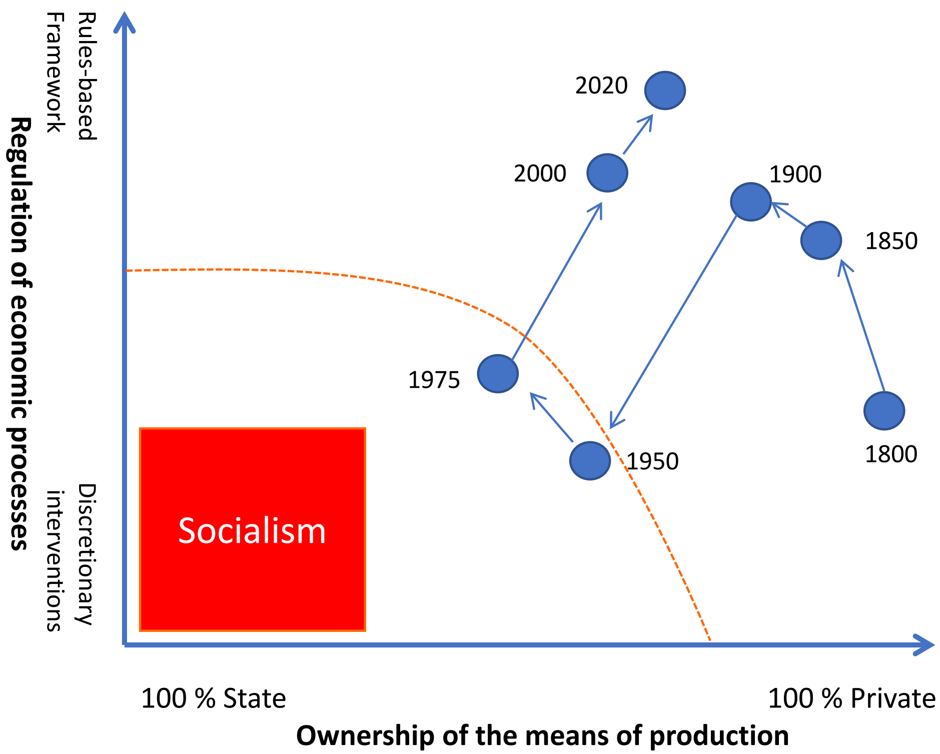
Economic systems between socialism and liberalism



Other major differentiating dimensions of economic systems:

- Decision making: decentralized vs. centralized
- Coordination: competitive market processes vs. non-competitive administrative processes
- Incentives: market- and rules-based vs. commands and directives
- Taxes: tax level and degree of tax neutrality
- International openness: free trade vs. autarchy

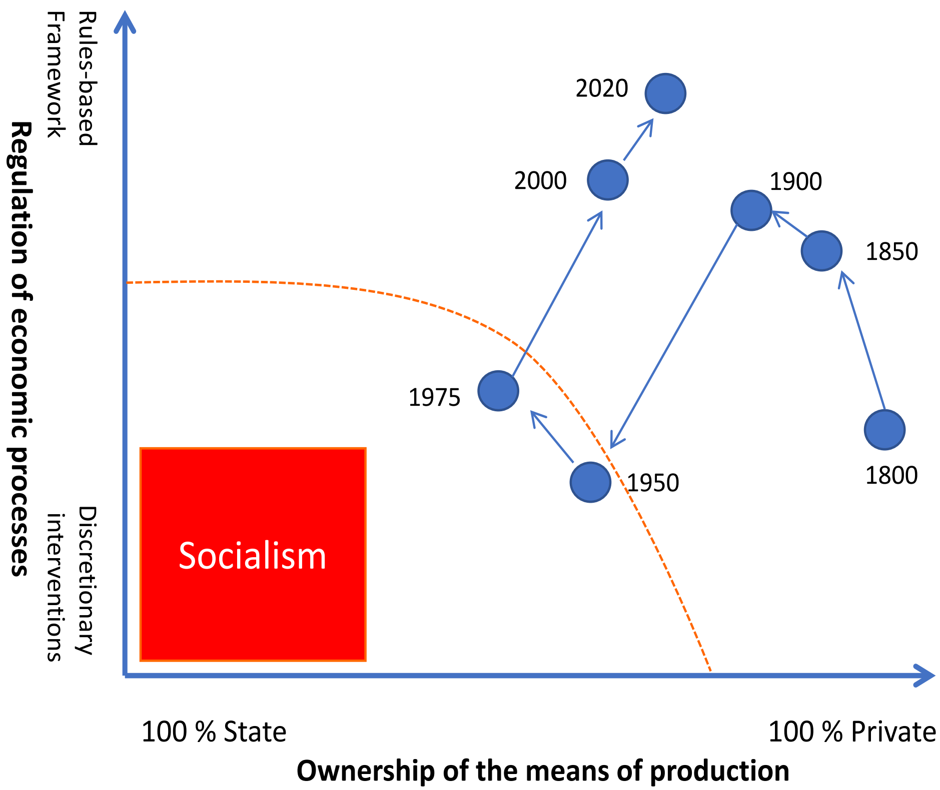
Norway's drift into and escape from economic socialism



Seven different Norwegian Models:

- 1800-1850: Pre-industrial mercantilism
- 1850-1914: Liberal modernisation and industrial revolution
- 1914-1940: Instability, social and labour reforms, protectionism
- 1940-1953: Heavy handed state-led interventions and collectivist planning
- 1953-1970: Mixed welfare state economy
- 1970-1981: hyper-keynesianism, expanded welfare state and ambitious interventionism and industrial policy
- 1981-2020: Gradual and significant ordoliberal reforms and welfare state adjustments

Norway's silent ordoliberal revolution since the 1980's

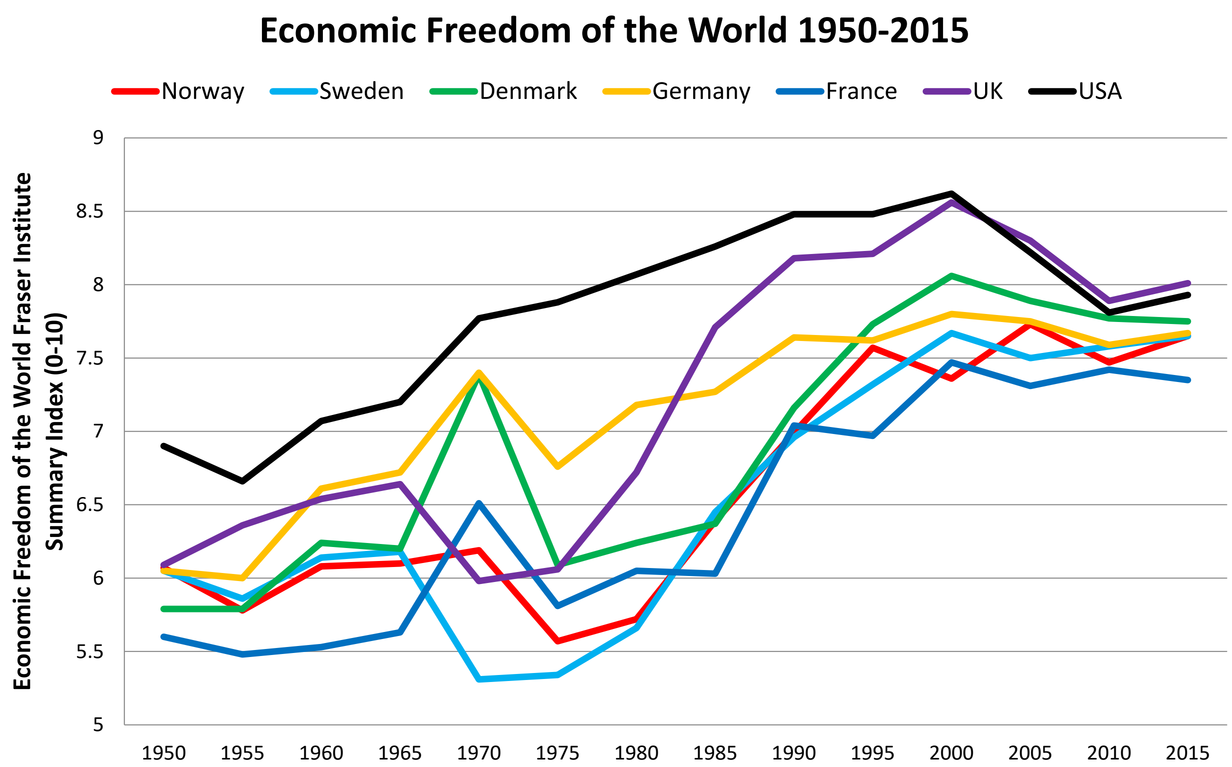


Areas of significant ordoliberal reforms:

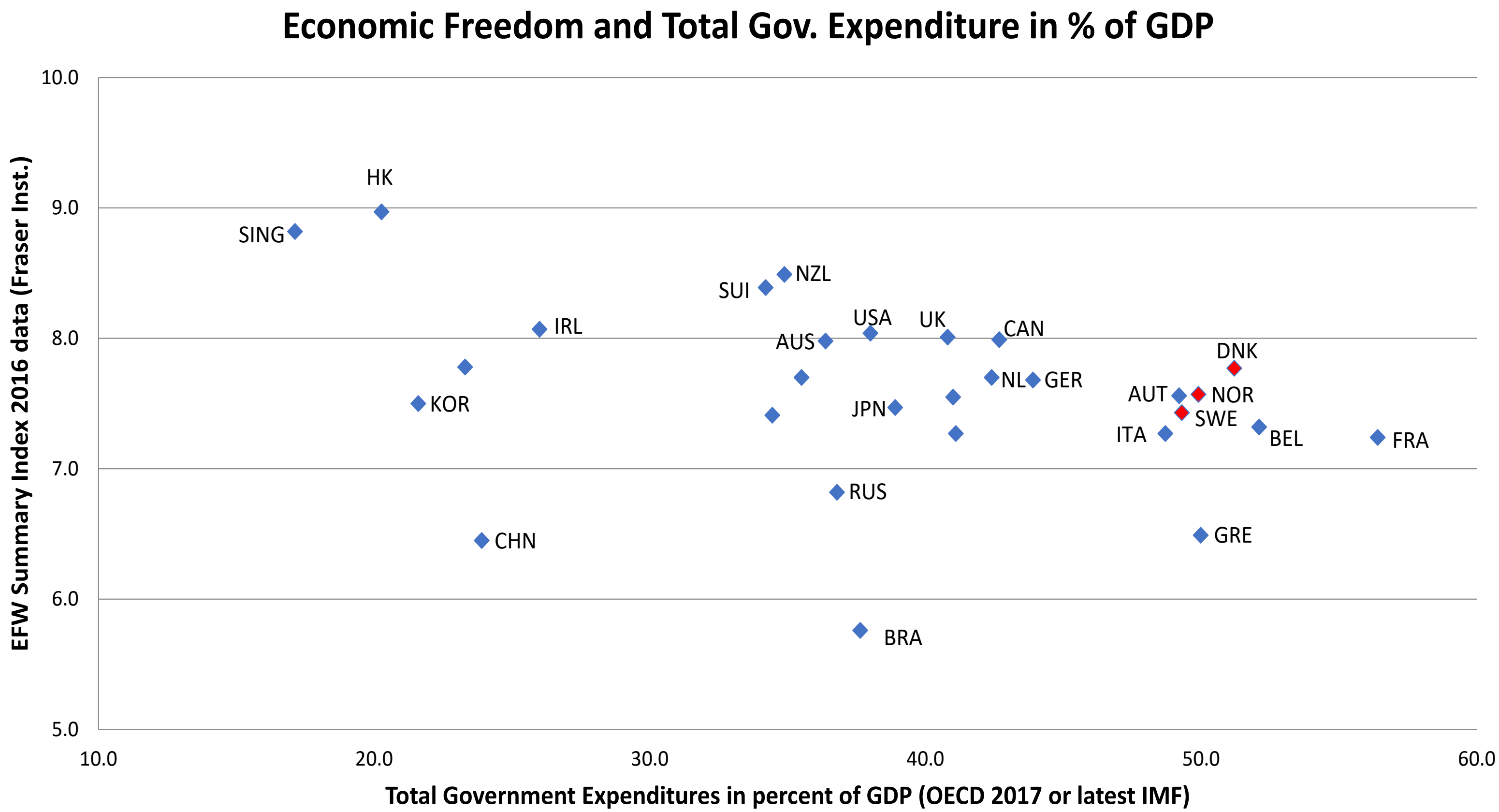
- Monetary policy: Independent central bank, floating exchange rates and and a rules-based monetary mandate
- Fiscal policy: Reductions in tax rates, more neutral taxes, widened tax base and a fiscal rule.
- Liberalized banking and finance sector
- International market opening, EEA-member
- Reformed competion and anti-trust regime (EU conforming)
- Opening new sectors to competition: broadcasting, telecom, internet, electicity, transport, education, welfare services
- Privatizations and new market conforming governance of remaining state owned enterprises
- Deregulation of the housing market
- Labour market reforms: new collective bargaining rules, more «flexicurity», pension reforms

	Macroeconomic stabilization, monetary and fiscal policies	Banking and finance	Market opening and competition	Sector regulation, deregulation and reforms of government ownership	Education, R&D and innovation	Labour market, pensions and housing market
1980-1989	(1978-1981: siste forsøk på å stanse inflasjon gjennom pris- og inntektsstopp)	1983: Ordinær bedriftsskatt for sparebanker 1983-1984: Opphevelse av direkte regulering av bankutlån 1985: Ny lov om Norges Bank 1986: Kredittilsynet etablert 1986: Markedsbestemte renter 1987: Ny sparebanklov, åpner for grunnfondsbevis		1981-84: Friere åpningstider i handelen 1982: Oppheving av kringkastings-monopolet (radio og tv) 1986-97: Liberalisering av luftfart 1986-94: Oppmyking av telemonopolet 1986: Større åpning og like-behandling av utenlandske selskaper på norsk sokkel		(1977: Arbeidsmiljølov 1979: Likestillingslov) 1981-84: Avregulering av boligmarkedet 1988: Innføring av AFP 1989: Innføring av foreldrepermisjonsordning
1990-1999	1990: Kronen bindes til ecu 1990: Vedtak om etabl. av et petroleumsfond (Nå: SPU) 1992: Stor skattereform (bredere grunnlag, lavere satser, mer likebehandling) 1992: Flytende valutakurs og økt uavhengighet for NB	1990: Opphevelse av reg. av internasj. kapitalbevegelser. Bankkrisen 1991-93: Staten tar over DNB, Fokus Bank og Kredittkassen 1999: Privatisering av Fokus Bank (Danske Bank)	1993: Konkurranselov 1994: Etabl. av Konkurransetilsynet (til erstatning av tidl. Prisdirektoratet og Statens pristilsyn) 1994: EØS-avtalen 1995: Medlem av WTO	1990-98: Serie av energi-markedsreformer som har skapt økt konkurranse og et integrert nordisk el-marked 1998: Liberalisering av telekom.-markedet	1994: Skolereform VGO og Høyskolereform 1997: Skolereform grunn-utdanning: 6 års skole-start og 10 år obligatorisk skolegang	1990-tallet..og senere: Et inntektspolitisk samarbeid som sikret moderate lønnsoppgjør 1998: Kontantstøtte til småbarnsforeldre
2000-2009	2001: Handlingsregelen for innfasing av oljepenger (4 %) 2001: Norges Bank innfører inflasjonsstyring 2006: Liten skattereform (marginalskatt, utbytte- og gevinstbeskatning)	2000: Privatisering av Kreditkassen (Nordea) 2003: Delprivatisering av DNB 2009: Finanstilsynet (tidl. Kredittilsynet)	2004: Ny konkurranselov tilpasset EUs konkurranselovgivning	2000-01: Reformer i statens forr. drift (større autonomi og konkurransenøytralitet) 2000-01: Delprivatisering av Statoil og Telenor 2000-01: Staten selger seg ut av 4 og ned i 7 selskaper 2001-05: Staten solgte seg ut av 4 selskaper og ned i 6 selskaper (herunder DNB, Telenor og Statoil) 2006: Konkurranseutsetting av Gjøvikbanen	2001: Kvalitetsreform for høyere utdanning (innført 2003-04) 2001: SkatteFUNN (F&U) 2003: Innovasjon Norge (samordning av off. virkemidler) 2003: Sentre for frem-ragende forskning 2003: Friskoleloven 2004: Kunnskapsløftet	2003: Barnehageforliket – full barnehagedekning 2004: Pensjonslovkom-misjonens utredning 2004: Pasientrettighetslov 2006: Ny arbeidsmiljølov 2006: Lovfestet tjeneste-pensjon for alle 2008: Ending i AFP-ordningen 2009: Pensjonsreform, mer fleks. pensjonsalder
2010-2017	2014-2017: Reduksjon av bedriftsskatten fra 28 % til 24 % 2014: Fjerning av arveavgiften 2014 og 2017: Reduksjoner i formueskatten 2017: Justering av handlingsregel til 3 %	2013: Innføring Basel III: økte kapitalkrav 2014: Ny lov om finansforetak og finanskonsern 2015: Innføring av motsykliske kapitalbuffere	(1990 til 2017: Inngåelse av 29 bilaterale handels-avtaler med i alt 40 land) 2014: Heving/fjerning av prod. tak i landbruket 2015-16: Innf. av nøytral MVA i statlig sektor 2017: Initiativ til fri-handelsavtale med Kina	2005-13: Staten solgte seg ut av 3 og ned i 3 selskaper 2013-17: Staten har solgt seg ut av Cermaq og solgt ned i Entra og SAS 2015: Etablering av nytt statlig veiselskap, Nye Veier, for effektivisering av større veiprosjekter 2016: Stor jernbanereform som åpner for økt konkurranse	2015: Lærerløftet 2015: Strukturreform for universitets- og høyskolesektoren 2017: KapitalFUNN (skatteinsentiv for Start-up finansiering)	2010-15: Flere pensjonslovendringer 2015: AML: Mer fleksible arbeidstidsbestemmelser og nye regler som åpner for betinget økt adgang til midlertidige ansettelser 2014-17: Kommune- og regionreform

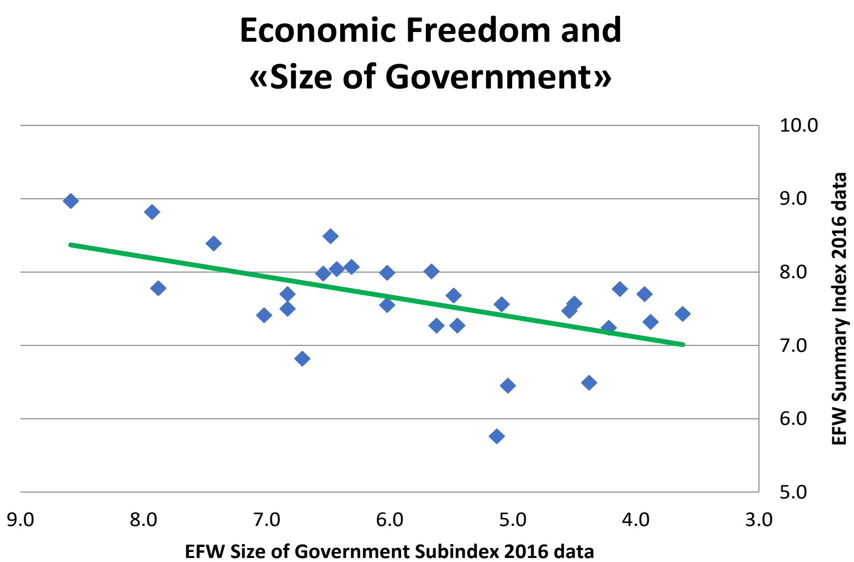
The Great Convergence after liberal reforms

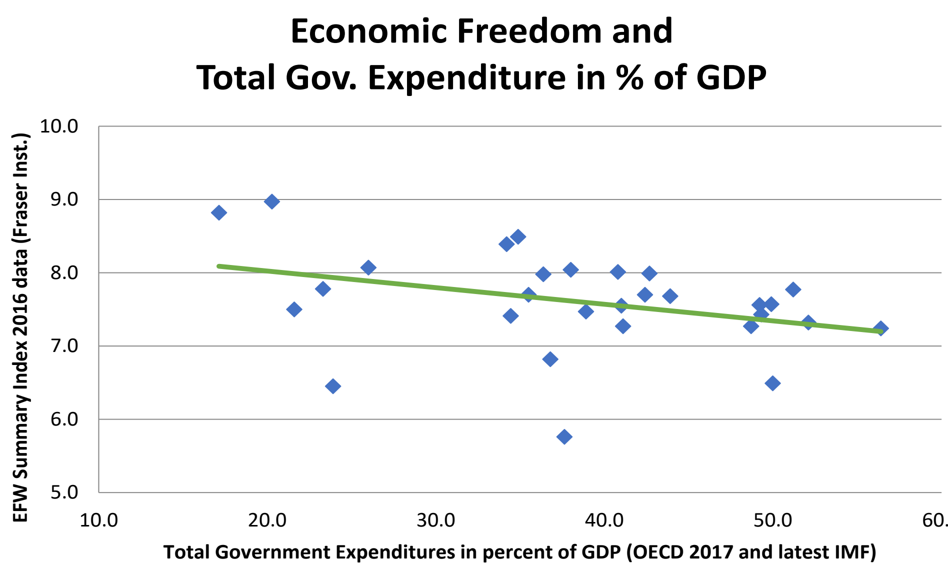


Similar level of Economic Freedom at different levels of Government Expenditures

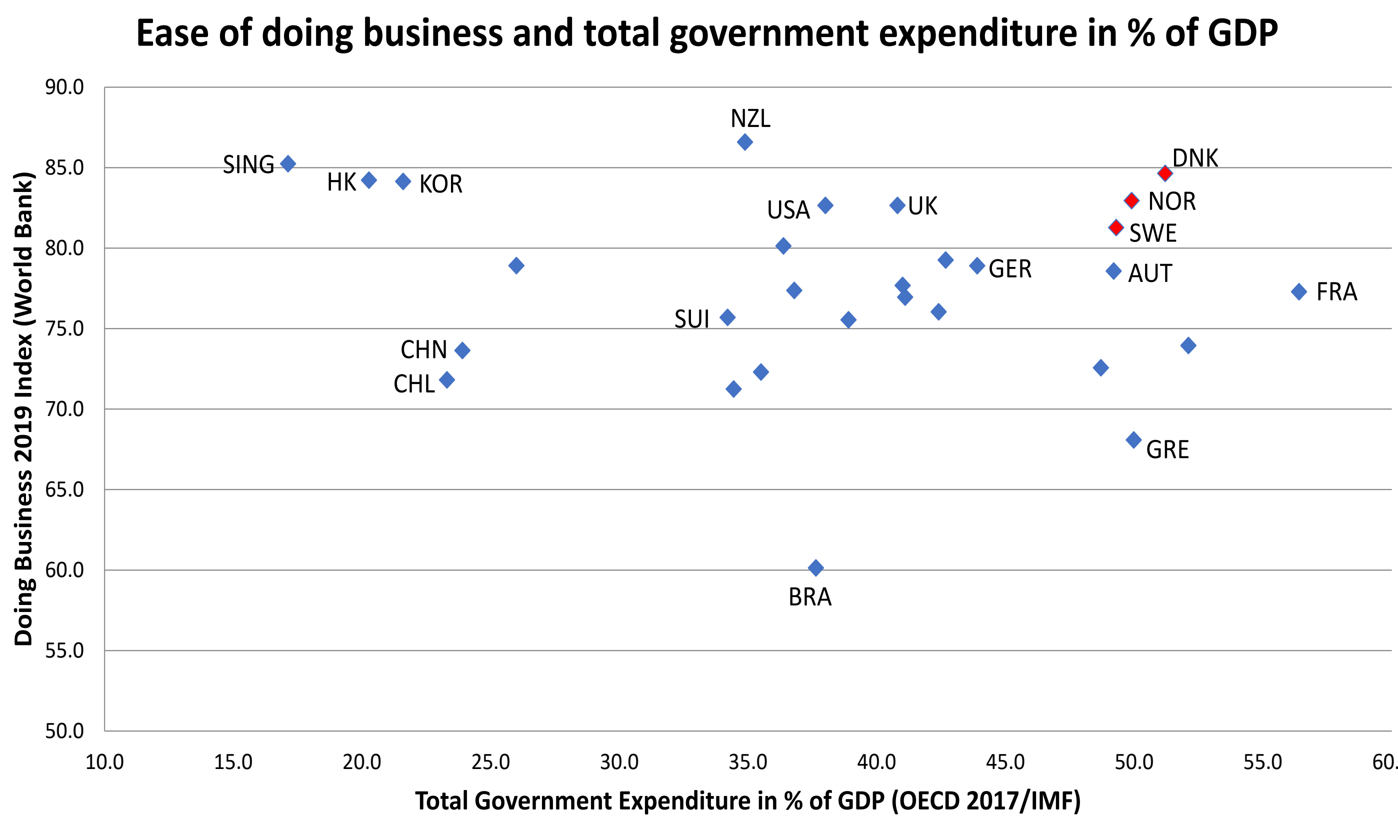


Economic Freedom and different measures of government size

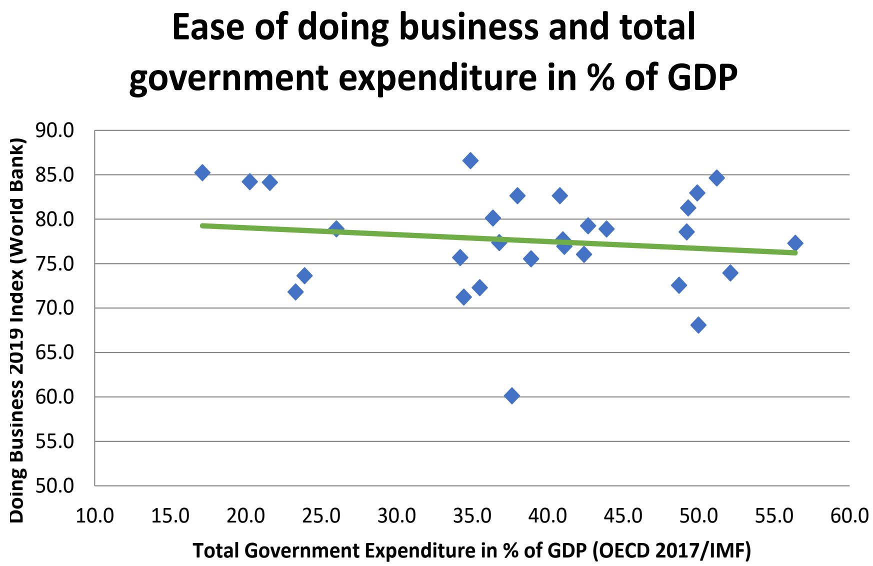


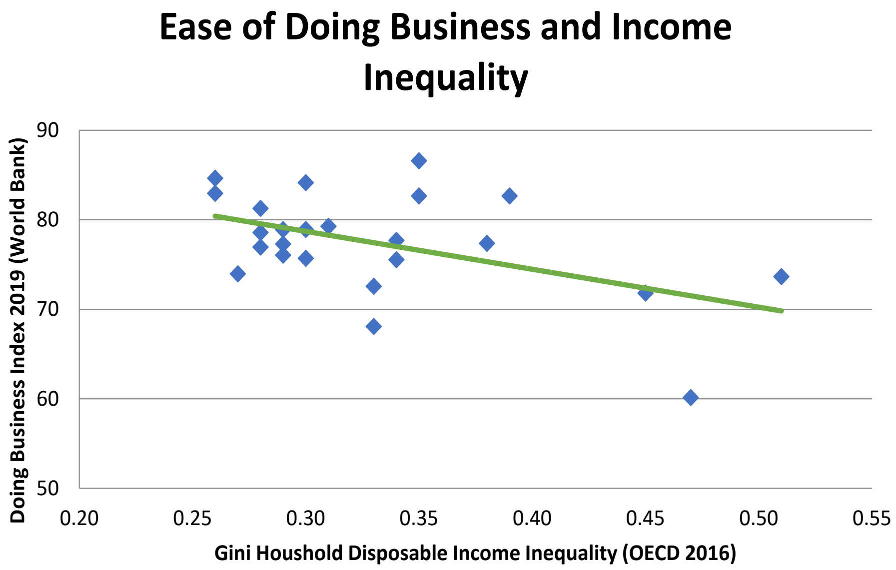


Similar level of Institutional Quality at different levels of Government Expenditures



The World Bank's Ease of Doing Business Index as a proxy for regulatory quality





The neo-interventionist threats to the liberal economic order

Economic Nationalism:

- Neo-mercantilist zero-sum international trade policies
- Assertive and disrupting unilateralism/bilateralism
- Discriminatory tariffs, managed trade deals, micro-exemptions etc.
- Systematic undermining of a rules-based multilateral world order and trading system
- The new spectre of (mostly right-wing) authoritarian national populisms with a nationalist-interventionist agenda

Micro-interventionism: Picking winners and loosers:

- New industrial policies
- «The entrepreneurial state»
- Foreign policy sanctions followed by discriminatory micro interventions
- Interventionist climate policies
- Lack of effective market and competition conforming regulations of the digital economy and platform-based giants

Hyper-concentration of economic and political power:

- Weaker competition
- Crony capitalism and the increasing role of money in politics
- Sophisticated regulatory capture
- Complex regulations and tax systems
- Dysfunctional (international) corporate tax system with anti-competitive outcomes
- Increasing inequality, decreasing social mobility
- Increase in executive political power and majoritarian power
- Disruptive politics and polarization

The neo-interventionist threats to the liberal economic order

Economic Nationalism:

- Neo-mercantilist zero-sum

Micro-interventionism: Picking winners and loosers:

Hyper-concentration of economic and political power:

The Neo-Nationalist Road to Socialism?

interventionist agenda

- Increase in executive political power and majoritarian power
- Disruptive politics and polarization

Do we need a new systems debate?

LARS PEDER NORDBAKKEN

CIVITA

Lars Peder Nordbakken is an economist with the liberal think tank Civita in Oslo, Norway, and a frequent writer and commentator on a range of political and economic policy issues. Nordbakken is also actively engaged with the history of economic and political ideas and with the continuing task of interpreting and renewing liberalism in response to a changing world.

His most recent book, *Liberale tenker for vår tid* (*Liberal Thinkers for Our Time*, 2017), presents, for the first time in Norway, a series of intellectual portraits of the main thinkers behind the revival of liberalism in Europe after the Second World War, including many prominent former members of the Mont Pelerin Society. His other major work is a book on the preconditions for the productive dynamism of a liberal market economy, *Muligheter for alle* (*Opportunities for Everyone*, 2006).

Nordbakken is currently working on a new book on the principles of liberal economic policy, combining insights from Austrian, institutional, and ordoliberal thinking. Nordbakken is also a board member of the foundation Liberalt forskningsinstitutt (Liberal Research Institute) and a business strategy consultant, and has for many years served on a senior executive level in the financial- and payment-services industry. He graduated from the Norwegian School of Economics in Bergen in 1980. Nordbakken has been a member of the Mont Pelerin Society since 2010 and a frequent participant since 2008, and is chairing the Organizing Committee of the next General Meeting in Oslo, Norway, September 1–5, 2020.

Economic Freedom Matters
Anthony Kim
Research Manager and Editor of the Index of Economic Freedom
The Heritage Foundation

Milton Friedman, whom the Economist once named "the most influential economist of the second half of the 20th century, possibly all of it,"[1] was the champion of the powerful idea that free markets and individual choice lead society to ultimate prosperity and overall well-being. His contributions to economic theory, and the conviction with which he espoused them, made him truly an extraordinary giant among political and economic thinkers.

Friedman's ideas and writings earned him the Nobel prize in economics, but his greatest legacy is unquestionably the improvement in living standards of people around the globe who have benefited from the implementation of his theories, even though they may have never read one of his books, attended one of his lectures, or even heard his name. As Friedman's ideas have been translated into public policy in countries around the globe, they have served as the invisible hand guiding and allowing millions to pursue their individual dreams, endowed with greater economic and political freedom. In reviewing Friedman's monumental *Capitalism and Freedom* more than five decades ago, *The Economist* magazine asserted that the book "makes ideal reading for politicians of either party in this country, not because it would convince them, but because it challenges the reader to sort out his own ideas more fundamentally."[2]

Indeed, many of Friedman's perspectives and policy ideas are not only far-reaching, but truly enduring throughout generations via his own publications, as well as through others' countless scholarly researches, whose underlying theses trace back to Friedman's insights. Friedman's economic, philosophical, and political writing has inspired decades of research in such diverse areas as welfare reform, competition in education, budget reform, and free trade.

The *Index of Economic Freedom*: Measuring Economic Freedom around the World

It goes without saying that people across the globe are particularly indebted to Milton Friedman for his role in championing economic freedom, and his ideas continue to live on today. Friedman elaborated "the role of competitive capitalism—the organization of the bulk of economic activity through private enterprise operating in a free market—as a system of economic freedom." Indeed, it was Friedman who first suggested that economic freedom of countries around the world be measured and monitored.[3]

The Heritage Foundation's *Index of Economic Freedom,* a data-driven policy guide that evaluates countries' economic policies and demonstrates why economic freedom matters, was first published in 1995. Since then, the *Index* has continued to echo many of Friedman's insights

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[1] "Milton Friedman: A Heavyweight Champ, at Five Foot Two," *The Economist*, November 23, 2006, http://www.economist.com/node/8313925
[2] "A Tract for the Times," *The Economist,* February 16, 1963, http://www.economist.com/node/8311321?story_id=8311321
[3] Lee Edwards, *The Power of Ideas: The Heritage Foundation at 25 Years*, (Ottawa, Ill.: Jameson Books, 1997), p. 152.

on the power of freedom, documenting countries' reform efforts, and monitoring ups and downs of economic freedom around the world.

Using metrics examining critical aspects of economic freedom such as government size, market openness, regulatory efficiency, and the rule of law, the *Index* has demonstrated the strong relationship between economic freedom and progress. The *Index* measures economic freedom based on quantitative and qualitative factors, which are grouped into four broad pillars of economic freedom. Each of the 12 economic freedoms within the 4 pillars is rated on a scale of 0 to 100. A country's overall score is derived by averaging these 12 economic freedoms, with equal weight being given to each.

As the *Index* documents, there is no single formula for overcoming challenges to economic development, but one thing is clear: Around the world, free market economies adopting and preserving policies that enhance economic freedom provide more opportunities, real progress, and greater prosperity for people.

To many who have long tracked economic freedom, the years since 2008 have served as a vivid reminder of the continuing struggle between the state and the free market. In times of uncertainty, it may be natural that people will look to their governments for answers. Yet the long-term solutions to our current economic problems do not lie in more government controls and regulations. They lie in a return to free-market principles.

Perhaps the most critical lesson of the past years of growing government intrusion into the free market system around the globe is that the fundamental superiority and value of economic liberty *must* be steadfastly reiterated, or even re-taught, to many political leaders and policymakers.

Economic Freedom is Key to Prosperity

The *Index* offers valuable evidence of the lasting values of freedom that Milton Friedman so keenly articulated and advocated:

> In the only cases in which the masses have escaped from the kind of grinding poverty you're talking about…they have had capitalism and largely free trade. . . .So that the record of history is absolutely crystal clear: that there is no alternative way so far discovered of improving the lot of the ordinary people that can hold a candle to the productive activities that are unleashed by a free enterprise system.[4]

As the *Index* has consistently illustrated over the past 25 years, the relationship between economic freedom and prosperity is strongly positive. Gross domestic product (GDP) per capita is much higher in countries with greater economic freedom. On average, economies rated "free" or "mostly free" enjoy incomes that are more than double the average levels in all other countries, and more than seven times higher than the incomes of "repressed" economies.

[4] "The Phil Donahue Show," 1979, See more in Travis Pantin, "Milton Friedman Answers Phil Donahue's Charges," The New York Sun, November 12, 2007, at http://www.nysun.com/business/milton-friedman-answers-phil-donahues-charges/66258/

More importantly, a sustained commitment to economic freedom is critical to ensuring economic growth and prosperity. Not only is a higher level of economic freedom clearly associated with a higher level of per capita income, but countries' improvements in economic freedom also tend to increase their income growth rates, ensuring economic and social progress.

Also notably, as Friedman suggested, economic freedom means free markets at home and around the world. Free trade drives prosperity, providing greater economic opportunity in countries that choose to embrace free-trade policies. On average, economies with the most trade freedom have the highest per capita GDP.

Economic Freedom Promotes Overall Well-being and Political Freedom

Of course, life is not just about money or wealth. As Friedman observed: "It is in the free societies that there has been a far greater development of the nonmaterial, spiritual, artistic aspects of well-being."[5]

In case after case, Friedman keenly observed that government interventions in free markets are not only futile, but tend to generate the exact opposite outcomes of their intended purpose. He called this unseen force that makes things go terribly and perversely wrong with government social programs the "invisible foot."[6]

It is economic freedom that effectively improves overall well-being for a greater number of people. The *Index* has documented various tangible non-materialistic benefits of living in freer societies administrated by limited government. As Friedman witnessed again and again, not only are higher levels of economic freedom associated with higher material prosperity, greater economic freedom also strongly correlates with overall well-being, which takes into account such factors as health, education, and personal safety.

Friedman also pointed out:

> Economic freedom plays a dual role in the promotion of a free society. On the one hand, freedom in economic arrangements is itself a component of freedom broadly understood, so economic freedom is an end in itself. In the second place, economic freedom is also an indispensable means toward the achievement of political freedom."[7]

The *Index* has empirically explored this critical relationship between economic freedom and political freedom or democratic governance. As shown in *the Index,* there is a strongly positive correlation between the two, and little doubt that higher levels in either generally have a positive impact on the other.

Economic Freedom Propels Entrepreneurial Dynamism

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[5]Milton Friedman, *Free Minds and Free Markets: Twenty-Five Years of Reason,* (San Francisco: Pacific Research Institute, 1993).
[6]Feulner, "Feulner on Friedman," and "Volume 1 - The Power of the Market, Free To Choose - Original 1980 Series," Free to Choose.TV, 1980, http://www.freetochoose.tv/
[7]Milton Friedman, *Capitalism and Freedom*, (Chicago: University of Chicago Press, 1962).

Economic freedom makes it possible for independent sources of wealth to counterbalance political power and to cultivate a pluralistic society. In other words, economic freedom underpins and reinforces political liberty and market-based democracy. As Friedman stated, "The greatest advances of civilization, whether in architecture or painting, in science and literature, in industry or agriculture, have never come from centralized government."[8]

As the *Index* has demonstrated, economic freedom is highly correlated with entrepreneurial activity in the private sector, creating new jobs and increasing opportunities and choices for individuals in advancing their own well-being. When individuals are allowed to decide themselves how best to pursue their dreams and aspirations, their collective achievements driven by individual choices, not by government mandates, add up to a better society for all.

To put it differently, economic freedom is positively linked to innovation that is often nurtured by free enterprise, not by central planning. The proven path to revitalizing economic growth is to advance economic freedom by promoting policies that generate a virtuous cycle of innovation, job creation, and productivity growth that, in turn, helps to advance the social and economic evolution.

Time to Renew Commitment to Greater Economic Freedom

Milton Friedman was confident that freedom would prevail, as indicated in the conclusion of *Free to Choose,* a powerful restatement of his beliefs co-authored with his wife Rose Friedman:

> Fortunately, we are waking up. We are again recognizing the dangers of an over-governed society, coming to understand that good objectives can be perverted by bad means, that reliance on the freedom of people to control their own lives in accordance with their own values is the surest way to achieve the full potential of a great society. Fortunately, also, we are as a people still free to choose which way we should go—whether to continue along the road we have been following to ever bigger government, or to call a halt and change direction.[9]

Though stated decades ago, the Friedmans' keen observations are shockingly relevant to today's challenging time. The reckless and populist policy choices of an increasingly leviathan government have placed the country on the path that diverges sharply from its historical quest for greater freedom. Worse, the system of "competitive capitalism" is being replaced by a crony capitalism that encourages the concentration of power that Friedman warned was one of the greatest threats to freedom.

Still, there are signs that, as in Friedman's day, the public is waking up, and maybe one can be optimistic that freedom will again prevail. Now is the time to renew our commitment to economic freedom, push forward policies that promote it, and instill confidence that a people who are free to choose will make the right decisions to ensure their future prosperity and happiness.

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[8]Ibid**.**
[9]Milton and Rose D. Friedman, *Free to Choose*, (Boston: Mariner Books, 1990).

A Special Meeting

The Mont Pelerin Society 1980 -2020

Hoover Institution, Stanford University

Economic Freedom

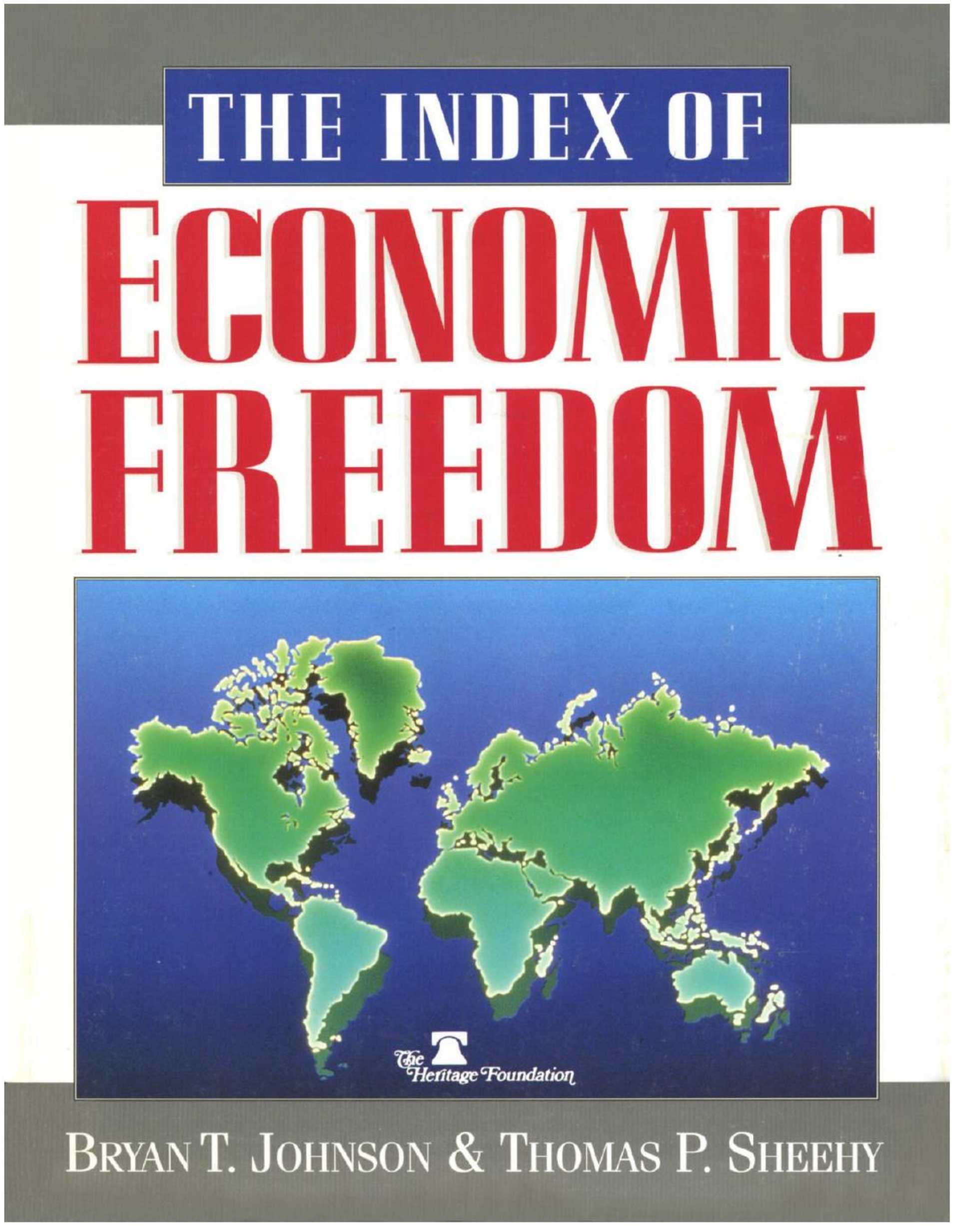
Promoting Economic Opportunity and Prosperity

The Heritage Foundation

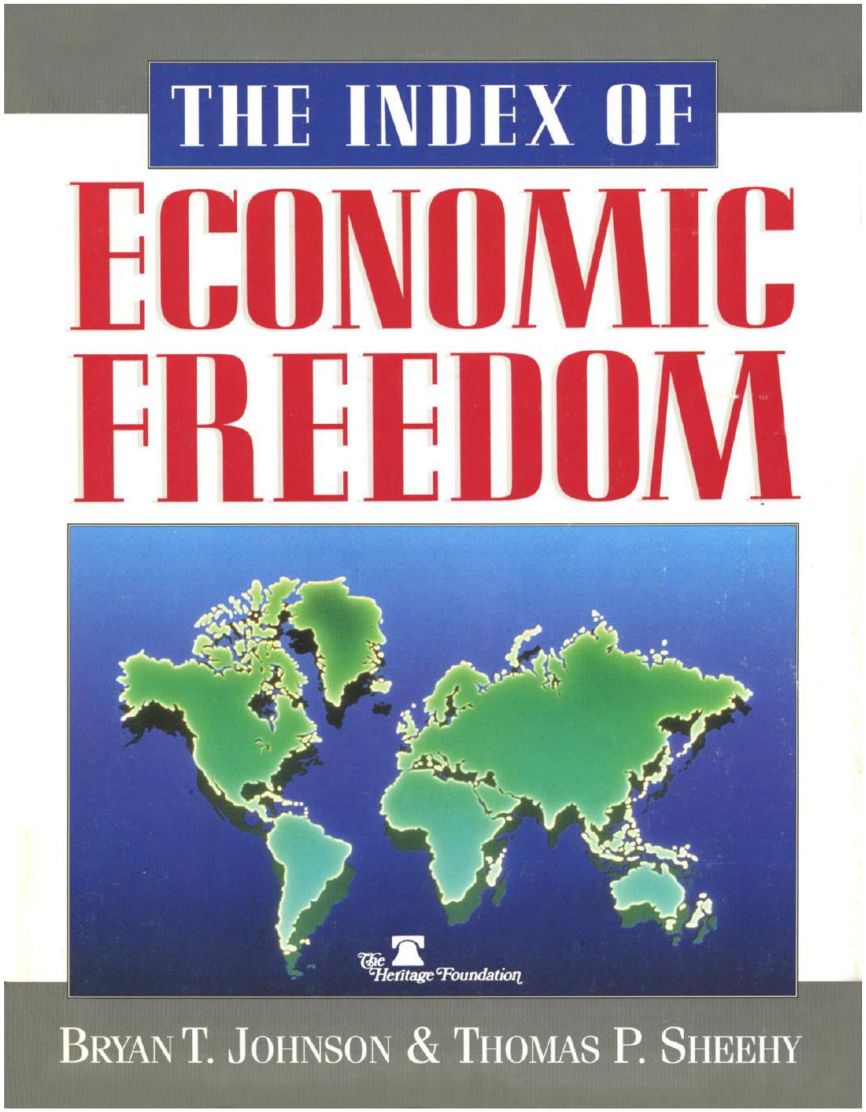
Anthony Kim

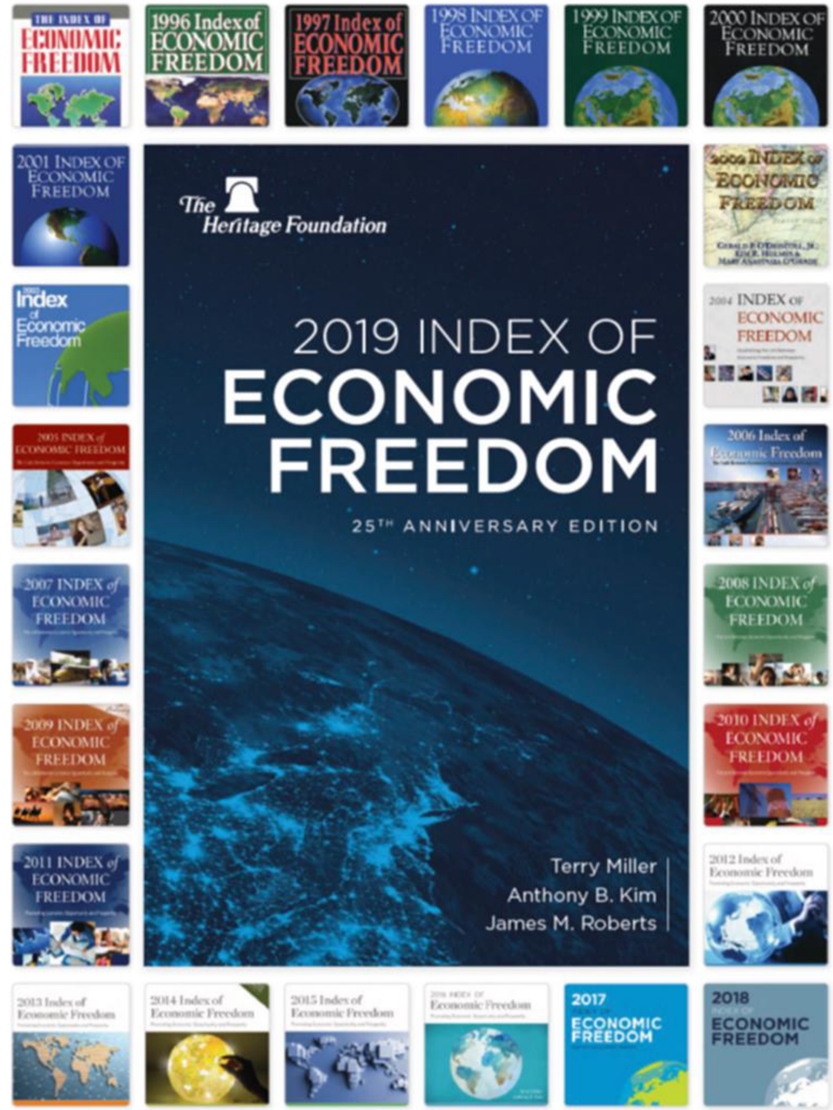
Research Manager and Editor of the Index of Economic Freedom

1995 Index of Economic Freedom

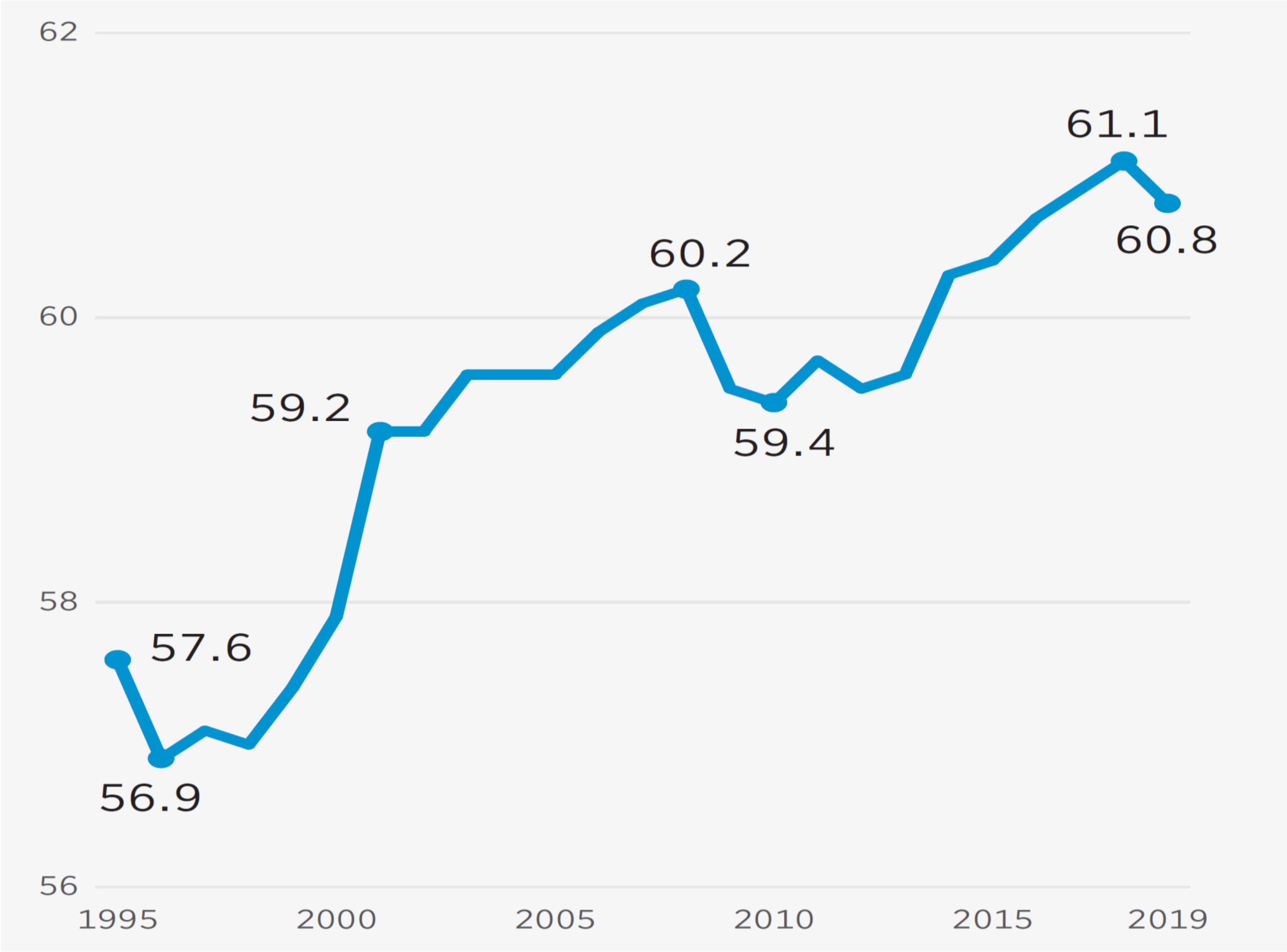


25 Years of Measuring Economic Freedom and Continuing

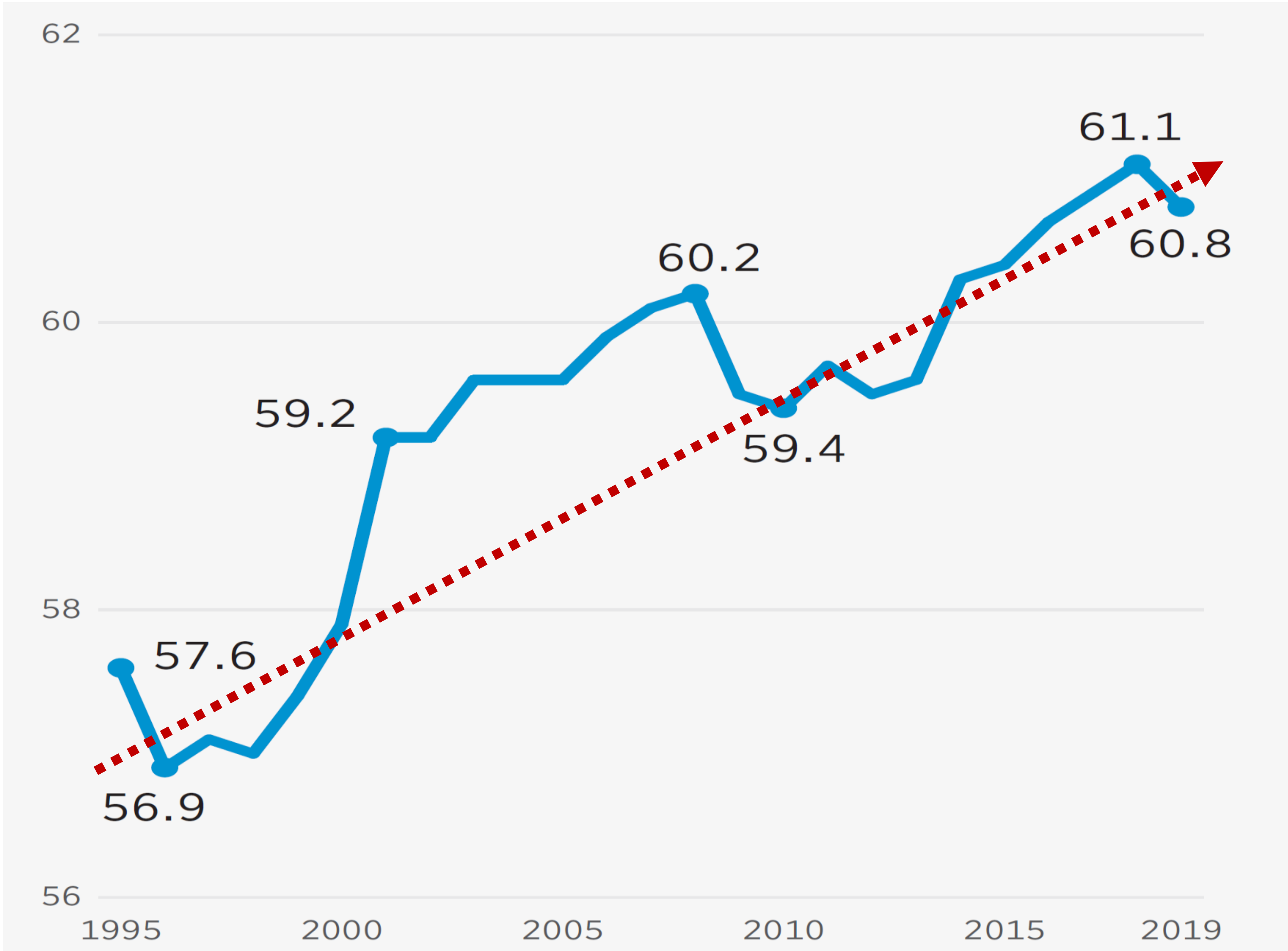




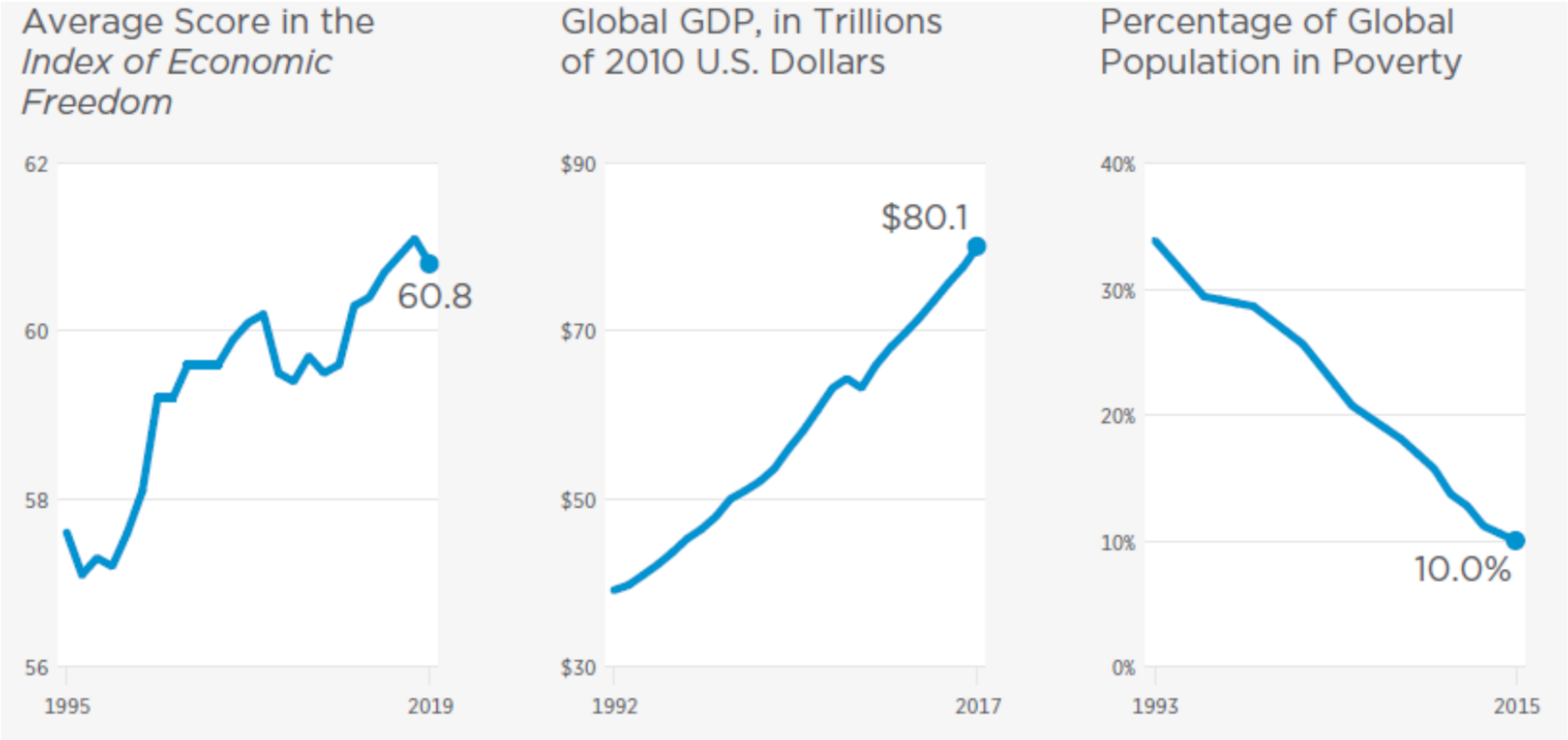
Global Economic Freedom Trend



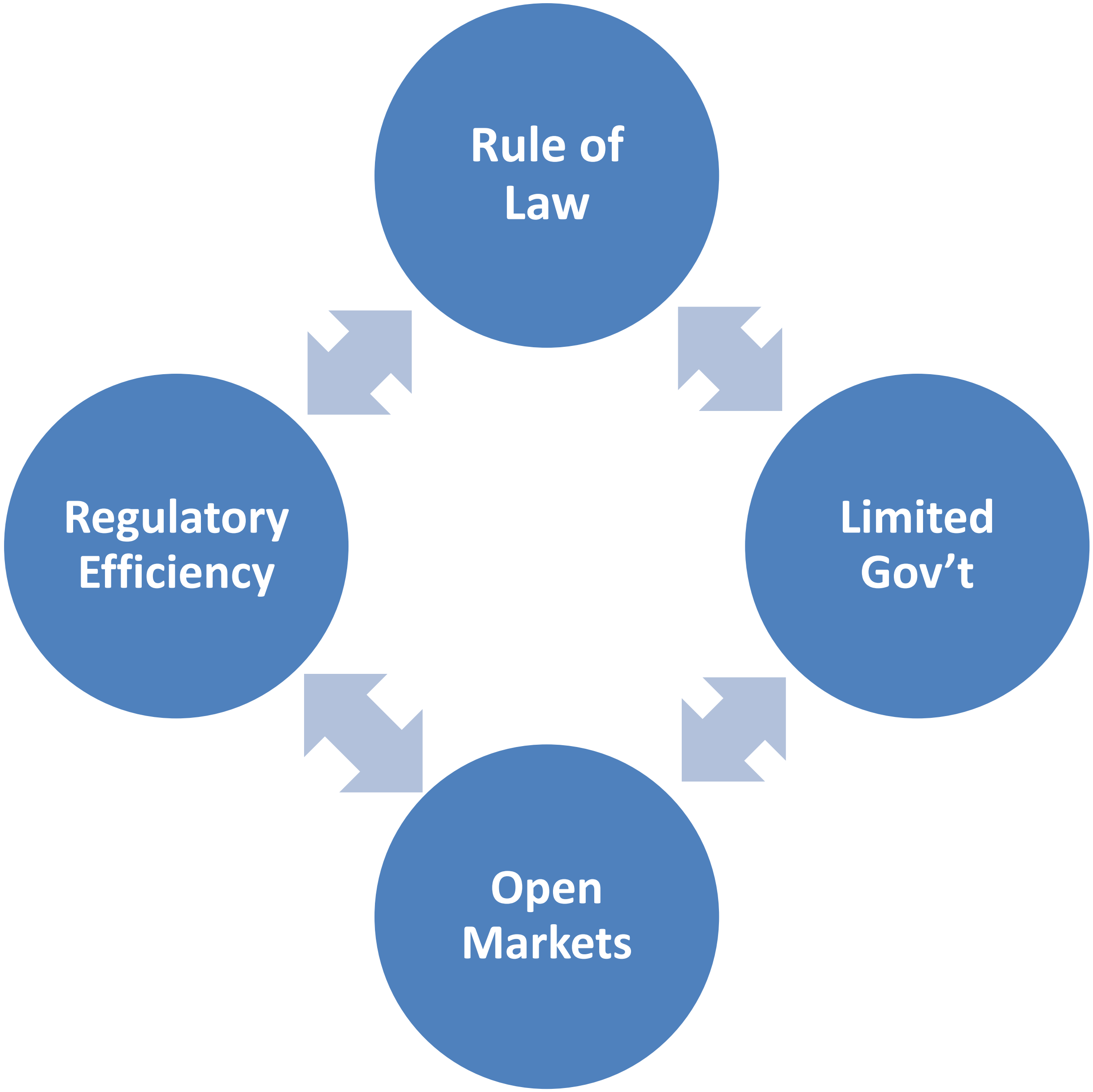
Rising Global Economic Freedom



As Economic Freedom Rises, The Global Economy Expands and Poverty Falls



4 Pillars of Economic Freedom



12 Components of Economic Freedom

- Rule of Law
  - **Property Rights**
  - **Judicial Effectiveness**
  - **Government Integrity**
- Government Size
  - **Tax Burden**
  - **Gov't Spending**
  - **Fiscal Health**
- Regulatory Efficiency
  - **Business Freedom**
  - **Labor Freedom**
  - **Monetary Freedom**
- Open Markets
  - **Trade Freedom**
  - **Investment Freedom**
  - **Financial Freedom**

- ***Each freedom is measured between 0 and 100.***
- ***An economy's overall economic freedom score is a simple average of the 12 factors (equal weighting).***

Rule of Law

Property Rights

- Physical property rights
- Intellectual property rights
- Strength of investor protection
- Risk of expropriation
- Quality of land administration

Judicial Effectiveness

- Judicial independence
- Quality of the judicial process
- Favoritism in decisions of government officials

Gov't Integrity

- Public trust in politicians
- Irregular payments and bribes
- Transparency of government policymaking
- Absence of corruption Perceptions of corruption
- Governmental and civil service transparency

Government Size

Tax Burden

- The top marginal tax rate on individual income
- The top marginal tax rate on corporate income
- The total tax burden as a percentage of GDP

Gov't Spending

- Government Expenditure as a percentage of GDP

Fiscal Health

- Average deficits as a percentage of GDP for the most recent three years
- Debt as a percentage of GDP

Regulatory Efficiency

Business Freedom

- Starting a business (time, procedures, cost, and minimum capital)
- Obtaining a license (time, procedures, and cost)
- Closing a business (time, procedures, and recovery rate)
- Getting electricity (time, procedures, and cost)

Labor Freedom

- Minimum wage
- Hindrance to hiring additional workers
- Rigidity of hours
- Difficulty of firing redundant employees
- Legally mandated notice
- Mandatory severance pay
- Labor force participation rate

Monetary Freedom

- The weighted average inflation rate for the most recent three years and
- Price controls

Open Market

Trade Freedom

- The trade-weighted average tariff rate
- Nontariff barriers (NTBs)

Investment Freedom

- National treatment of foreign investment
- Foreign investment code
- Restrictions on land ownership
- Sectoral investment restrictions
- Expropriation of investments
- Foreign exchange controls
- Capital controls

Financial Freedom

- The extent of gov't regulation of financial services
- State intervention through direct and indirect ownership
- Gov't influence on the allocation of credit
- Financial and capital market development
- Openness to foreign competition

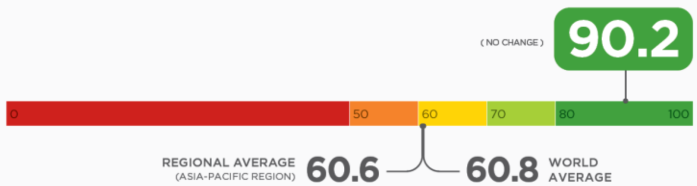
Index of Economic Freedom

HONG KONG

Hong Kong's economic freedom score is 90.2, sustaining its status as the world's freest economy in the 2019 *Index*. Its overall score is unchanged from 2018, with increases in scores for **trade freedom**, **monetary freedom**, and **government integrity** countered by a decline in **judicial effectiveness**. Hong Kong is ranked 1st among 43 countries in the Asia–Pacific region, and its overall score is well above the regional and world averages.

Moderately looser fiscal policy encouraged economic growth in 2018, but U.S.–China trade frictions could have significant negative repercussions. An exceptionally competitive financial and business hub, Hong Kong remains one of the world's most resilient economies. A high-quality legal framework provides effective protection of property rights and strongly supports the rule of law. There is little tolerance for corruption, and a high degree of transparency enhances government integrity. Regulatory efficiency and openness to global commerce undergird a vibrant entrepreneurial climate.

ECONOMIC FREEDOM SCORE



RELATIVE STRENGTHS: Fiscal Health and Business Freedom

HISTORICAL *INDEX* SCORE CHANGE (SINCE 1995): +1.6

CONCERNS: Judicial Effectiveness and Government Integrity

FREEDOM TREND

QUICK FACTS

POPULATION: 7.4 million

GDP (PPP): $454.9 billion
3.8% growth in 2017
5-year compound annual growth 2.8%
$61,393 per capita

UNEMPLOYMENT: 3.1%

INFLATION (CPI): 1.5%

FDI INFLOW: $104.3 billion

PUBLIC DEBT: 0.1% of GDP

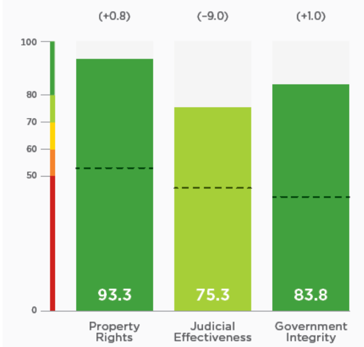
2017 data unless otherwise noted. Data compiled as of September 2018

BACKGROUND: Hong Kong became a Special Administrative Region of the People's Republic of China in 1997. Carrie Lam began a five-year term as chief executive in 2017. Under the "one country, two systems" agreement, China granted Hong Kong a high degree of autonomy in all matters except foreign and defense policy for 50 years. This policy has been strained by PRC political interference in recent years, and the Hong Kong government's decision in 2018 to ban a pro-independence party led to protests and raised concerns about future prospects for freedom of speech and association in the SAR. Despite the political unrest, Hong Kong's open and market-driven economy continues to flourish, increasingly integrated with the mainland through trade, tourism, and financial links.

— — WORLD AVERAGE | ONE-YEAR SCORE CHANGE IN PARENTHESES

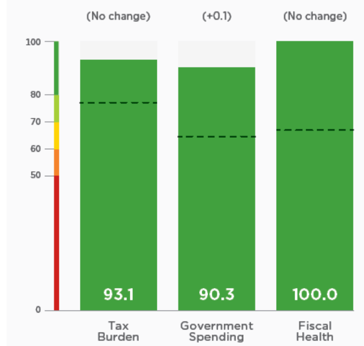
12 ECONOMIC FREEDOMS | HONG KONG

RULE OF LAW



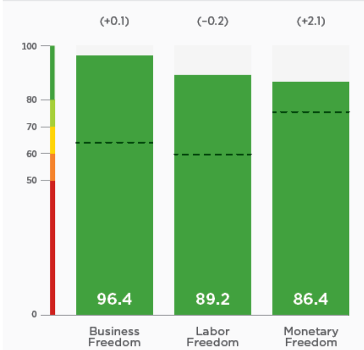
Property rights are effectively enforced and enshrined in the Basic Law, which serves in effect as the SAR's constitution. Commercial and company laws uphold the sanctity of contracts. The judiciary is independent, but Beijing reserves the right to make final interpretations of the Basic Law, effectively limiting the power of Hong Kong's Court of Final Appeal. Hong Kong has an excellent record of combatting corruption.

GOVERNMENT SIZE



The standard income tax rate is 15 percent, and the top corporate tax rate is 16.5 percent. The tax system is simple and efficient. The overall tax burden equals 14.0 percent of total domestic income. Over the past three years, government spending has amounted to 17.9 percent of the country's output (GDP), and budget surpluses have averaged 3.4 percent of GDP. Public debt is equivalent to 0.1 percent of GDP.

REGULATORY EFFICIENCY

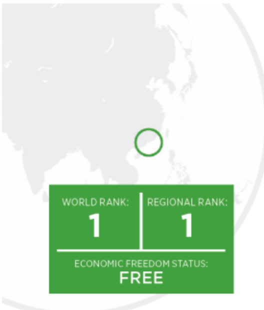


Business freedom is well protected within an efficient regulatory framework. Transparency encourages entrepreneurship, and the overall environment is conducive to the start-up of businesses. The labor code is strictly enforced but not burdensome. Very few price controls are in place, but the government regulates residential rents and in 2018 announced that it will study possible increases in transportation subsidies.

OPEN MARKETS

The combined value of exports and imports is equal to 375.1 percent of GDP. The average applied tariff rate is 0.0 percent. As of June 30, 2018, according to the WTO, Hong Kong had 149 nontariff measures in force. Hong Kong is very open to global trade and investment. The financial regulatory environment focuses on ensuring transparency and enforcing prudent minimum standards. There are no restrictions on foreign banks.

Index of Economic Freedom

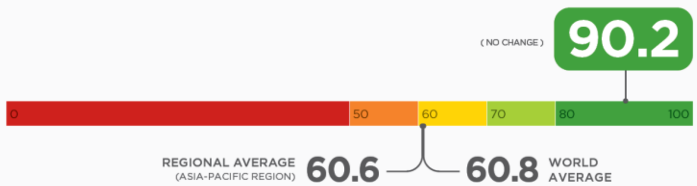


HONG KONG

Hong Kong's economic freedom score is 90.2, sustaining its status as the world's freest economy in the 2019 *Index*. Its overall score is unchanged from 2018, with increases in scores for **trade freedom**, **monetary freedom**, and **government integrity** countered by a decline in **judicial effectiveness**. Hong Kong is ranked 1st among 43 countries in the Asia–Pacific region, and its overall score is well above the regional and world averages.

Moderately looser fiscal policy encouraged economic growth in 2018, but U.S.–China trade frictions could have significant negative repercussions. An exceptionally competitive financial and business hub, Hong Kong remains one of the world's most resilient economies. A high-quality legal framework provides effective protection of property rights and strongly supports the rule of law. There is little tolerance for corruption, and a high degree of transparency enhances government integrity. Regulatory efficiency and openness to global commerce undergird a vibrant entrepreneurial climate.

ECONOMIC FREEDOM SCORE



RELATIVE STRENGTHS: Fiscal Health and Business Freedom

HISTORICAL *INDEX* SCORE CHANGE (SINCE 1995): +1.6

CONCERNS: Judicial Effectiveness and Government Integrity

FREEDOM TREND

QUICK FACTS

POPULATION: 7.4 million

GDP (PPP): $454.9 billion
3.8% growth in 2017
5-year compound annual growth 2.8%
$61,393 per capita

UNEMPLOYMENT: 3.1%

INFLATION (CPI): 1.5%

FDI INFLOW: $104.3 billion

PUBLIC DEBT: 0.1% of GDP

2017 data unless otherwise noted. Data compiled as of September 2018

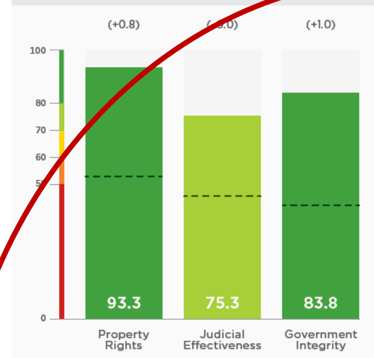
BACKGROUND: Hong Kong became a Special Administrative Region of the People's Republic of China in 1997. Carrie Lam began a five-year term as chief executive in 2017. Under the "one country, two systems" agreement, China granted Hong Kong a high degree of autonomy in all matters except foreign and defense policy for 50 years. This policy has been strained by PRC political interference in recent years, and the Hong Kong government's decision in 2018 to ban a pro-independence party led to protests and raised concerns about future prospects for freedom of speech and association in the SAR. Despite the political unrest, Hong Kong's open and market-driven economy continues to flourish, increasingly integrated with the mainland through trade, tourism, and financial links.

220 2019 Index of Economic Freedom

— — WORLD AVERAGE | ONE-YEAR SCORE CHANGE IN PARENTHESES

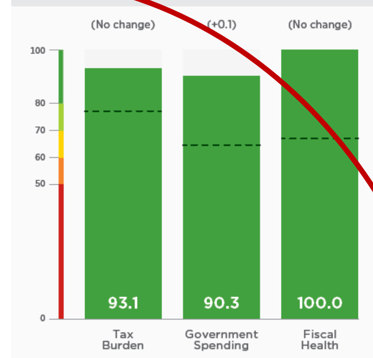
12 ECONOMIC FREEDOMS | HONG KONG

RULE OF LAW



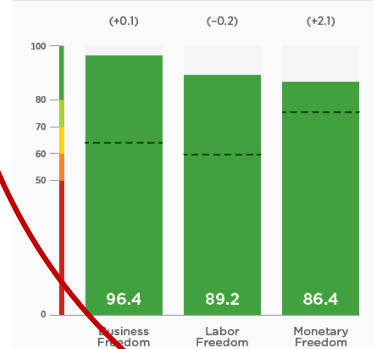
Property rights are effectively enforced and enshrined in the Basic Law, which serves in effect as the SAR's constitution. Commercial and company laws uphold the sanctity of contracts. The judiciary is independent, but Beijing reserves the right to make final interpretations of the Basic Law, effectively limiting the power of Hong Kong's Court of Final Appeal. Hong Kong has an excellent record of combatting corruption.

GOVERNMENT SIZE



The standard income tax rate is 15 percent, and the top corporate tax rate is 16.5 percent. The tax system is simple and efficient. The overall tax burden equals 14.0 percent of total domestic income. Over the past three years, government spending has amounted to 17.9 percent of the country's output (GDP), and budget surpluses have averaged 3.4 percent of GDP. Public debt is equivalent to 0.1 percent of GDP.

REGULATORY EFFICIENCY



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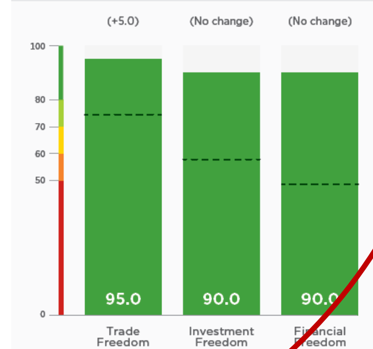
OPEN MARKETS



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The Heritage Foundation | heritage.org/Index 221

Which Economies Are Leading?

SIX "FREE" NATIONS

Hong Kong | **Singapore** | **New Zealand** | **Switzerland** | **Australia** | **Ireland**

REGIONAL LEADERS

Hong Kong	United Arab Emirates	Mauritius	Switzerland	Canada

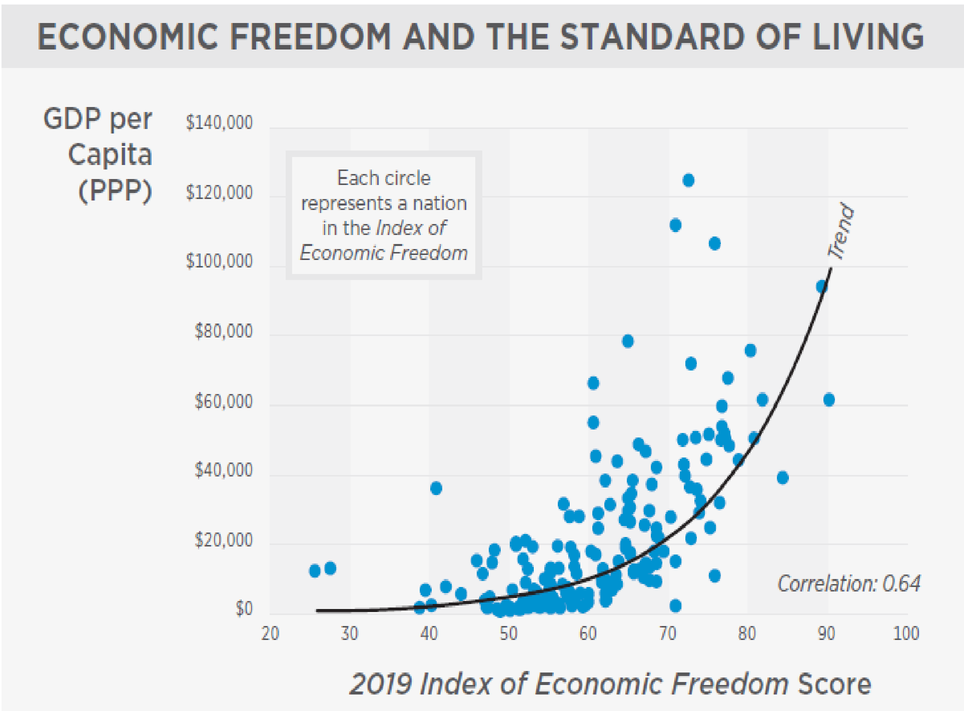
ASIA-PACIFIC	MIDDLE EAST/ NORTH AFRICA	SUB-SAHARAN AFRICA	EUROPE	AMERICAS

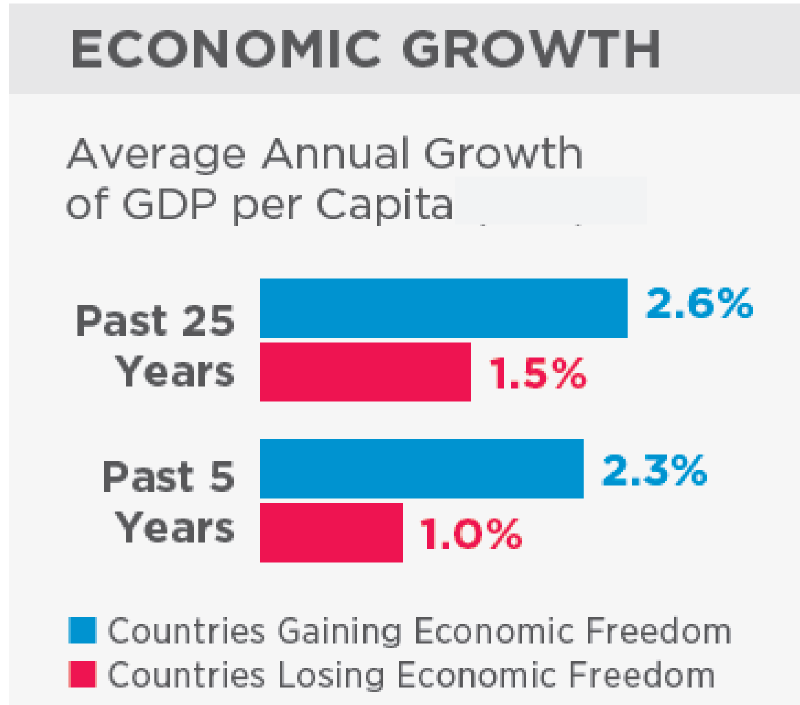
Top 20 vs. Bottom 20

Rank	Country	Overall Score
1	Hong Kong	90.2
2	Singapore	89.4
3	New Zealand	84.4
4	Switzerland	81.9
5	Australia	80.9
6	Ireland	80.5
7	United Kingdom	78.9
8	Canada	77.7
9	United Arab Emirates	77.6
10	Taiwan	77.3
11	Iceland	77.1
12	United States	76.8
13	Netherlands	76.8
14	Denmark	76.7
15	Estonia	76.6
16	Georgia	75.9
17	Luxembourg	75.9
18	Chile	75.4
19	Sweden	75.2
20	Finland	74.9

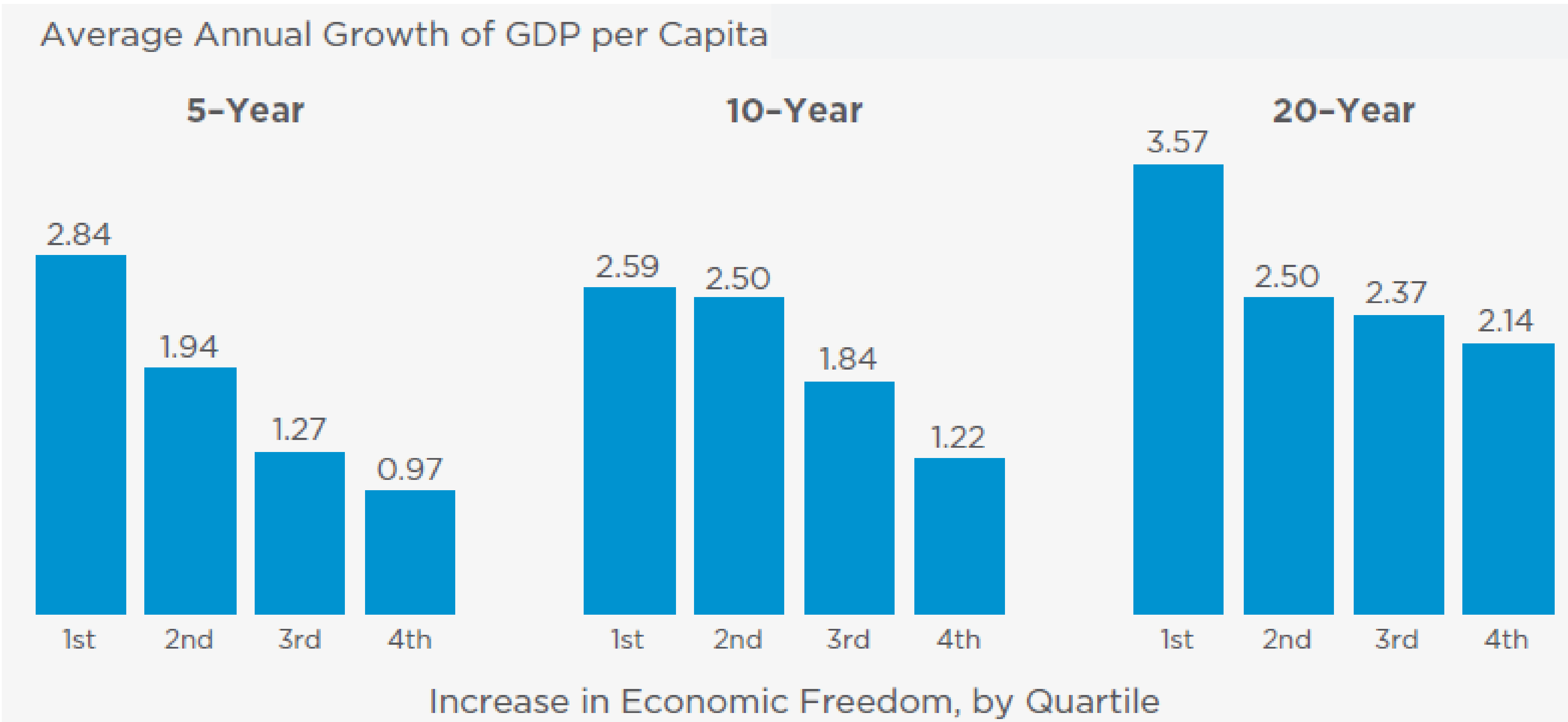
Rank	Country	Overall Score
160	Liberia	49.7
161	Central African Republic	49.1
162	Burundi	48.9
163	Mozambique	48.6
164	Turkmenistan	48.4
165	Suriname	48.1
166	Sudan	47.7
167	Sierra Leone	47.5
168	Kiribati	47.3
169	Djibouti	47.1
170	Ecuador	46.9
171	Algeria	46.2
172	Timor-Leste	44.2
173	Bolivia	42.3
174	Equatorial Guinea	41.0
175	Zimbabwe	40.4
176	Republic of Congo	39.7
177	Eritrea	38.9
178	Cuba	27.8
179	Venezuela	25.9
180	North Korea	5.9

With Economic Freedom Comes Greater Prosperity and More Vibrant Growth

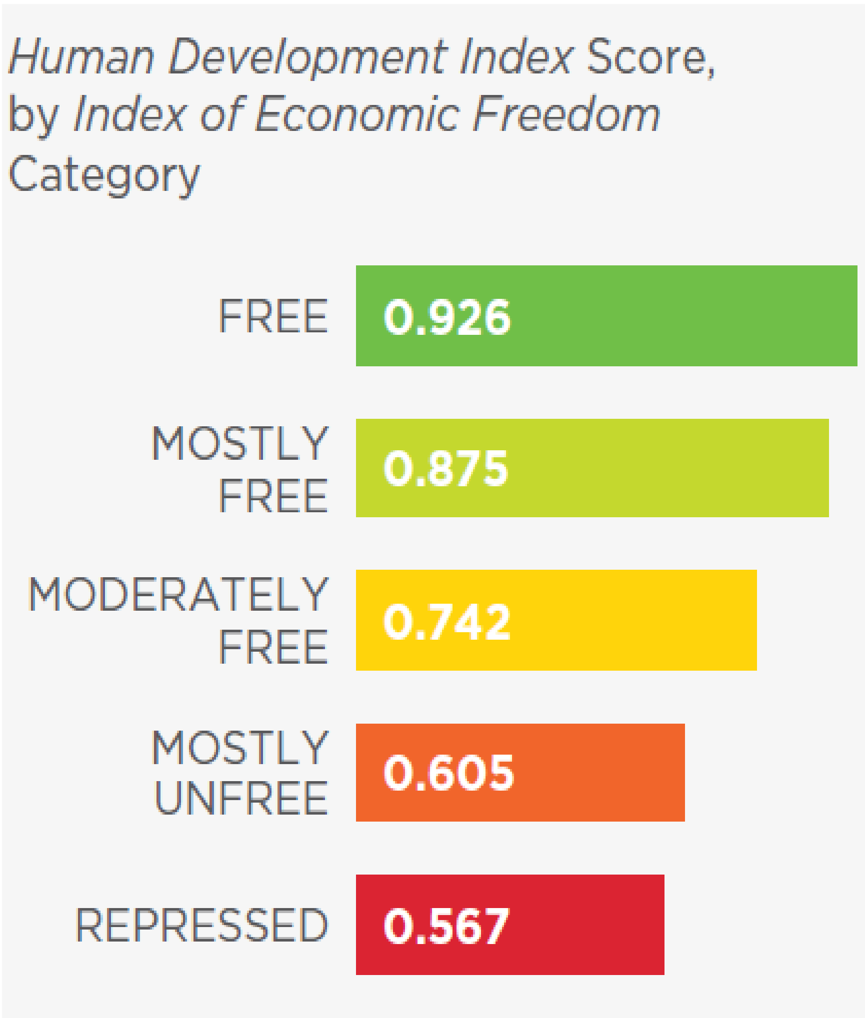


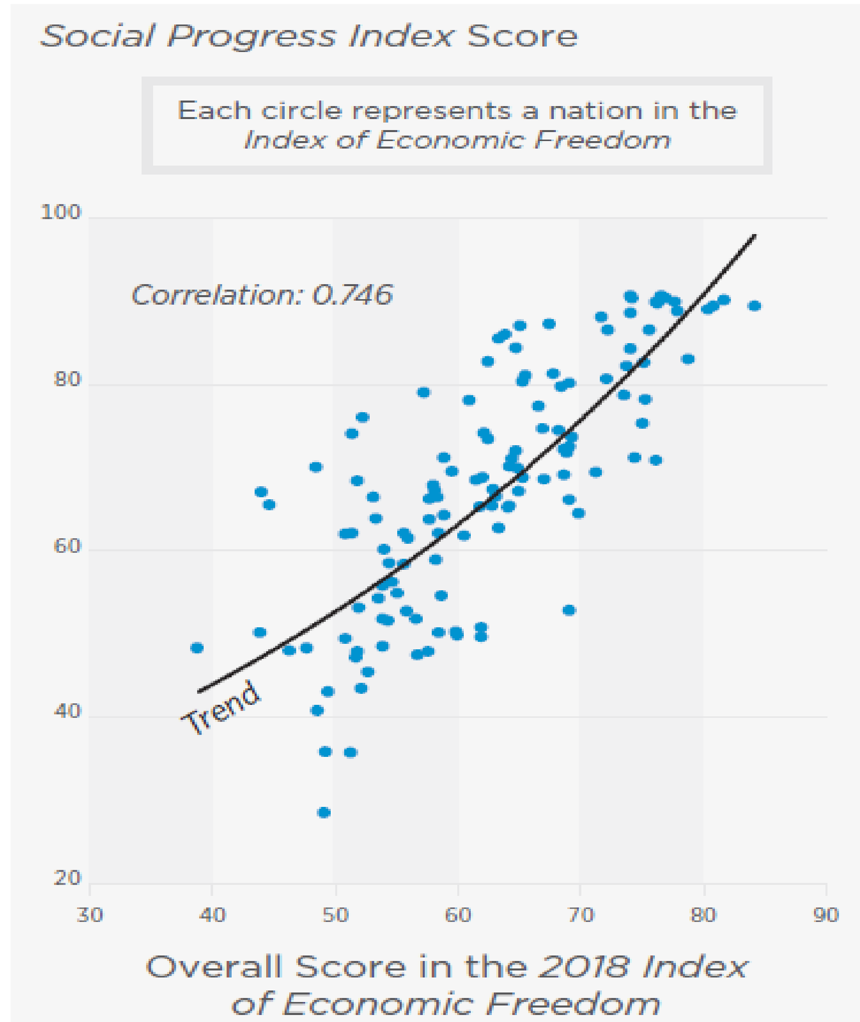


With Economic Freedom Comes More Vibrant Growth

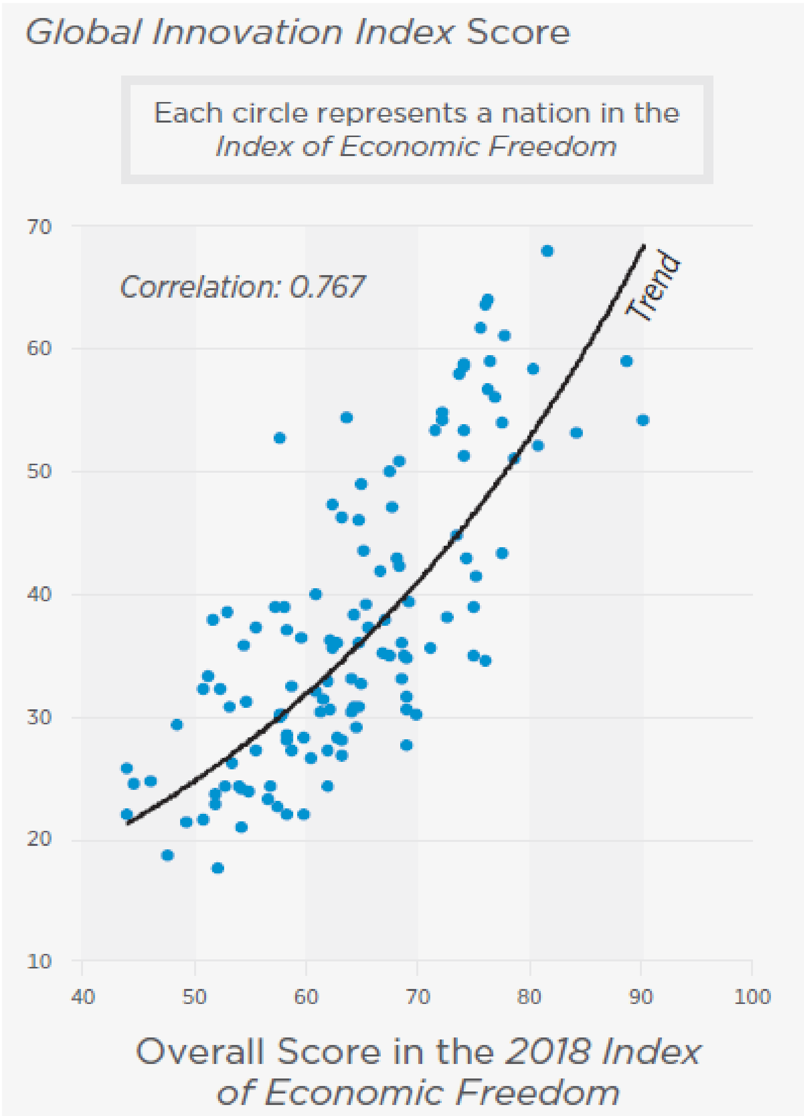


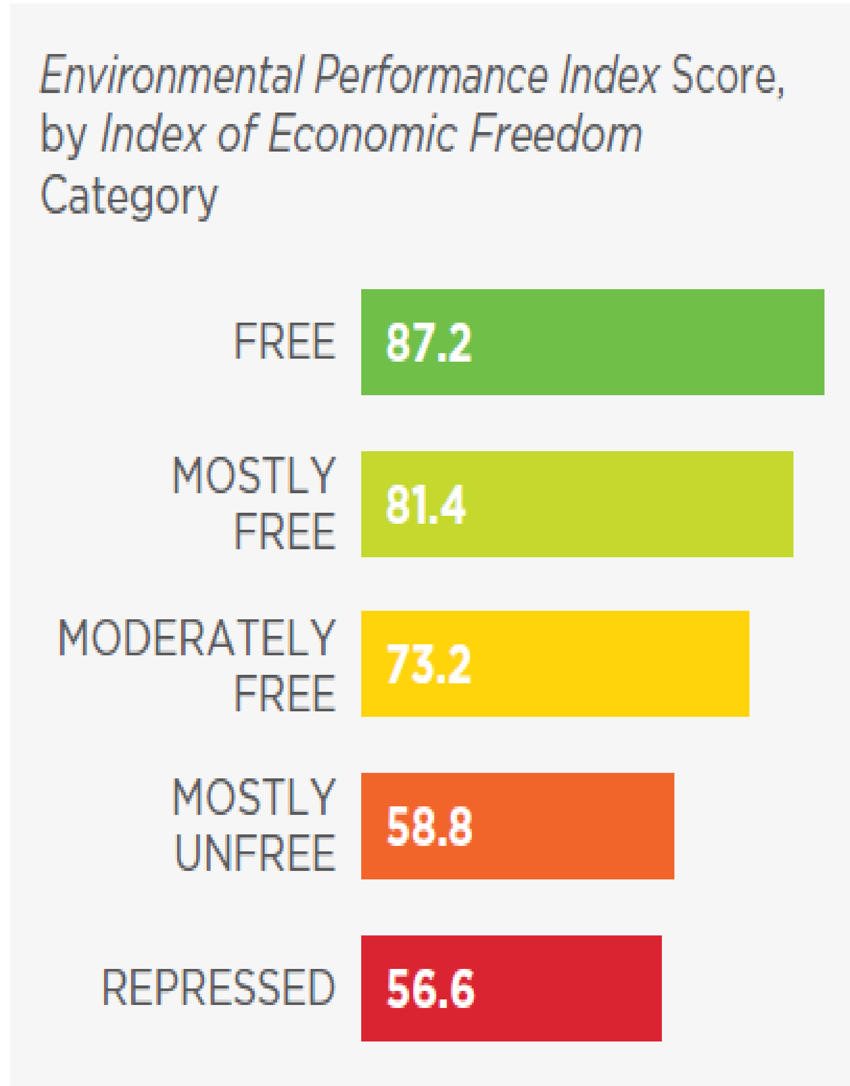
Economic Freedom:
Key to Human Development and Social Progress



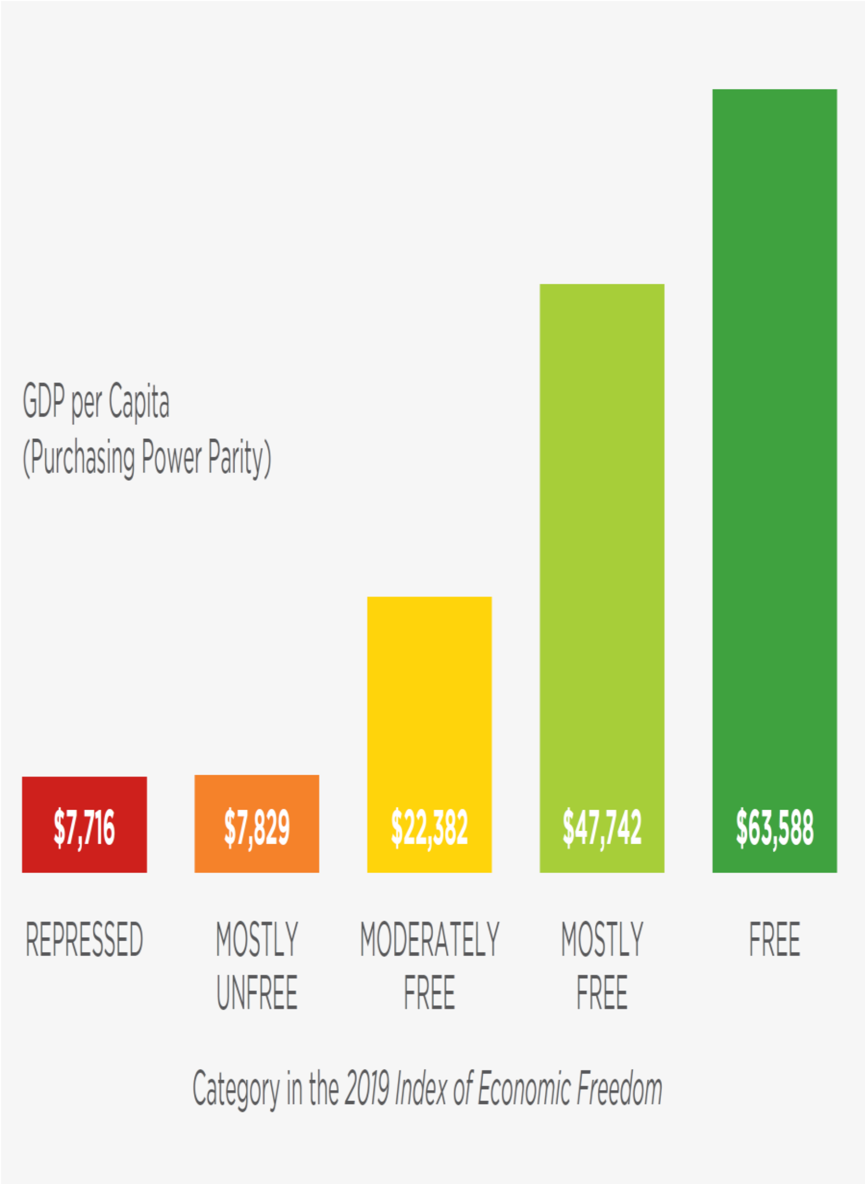


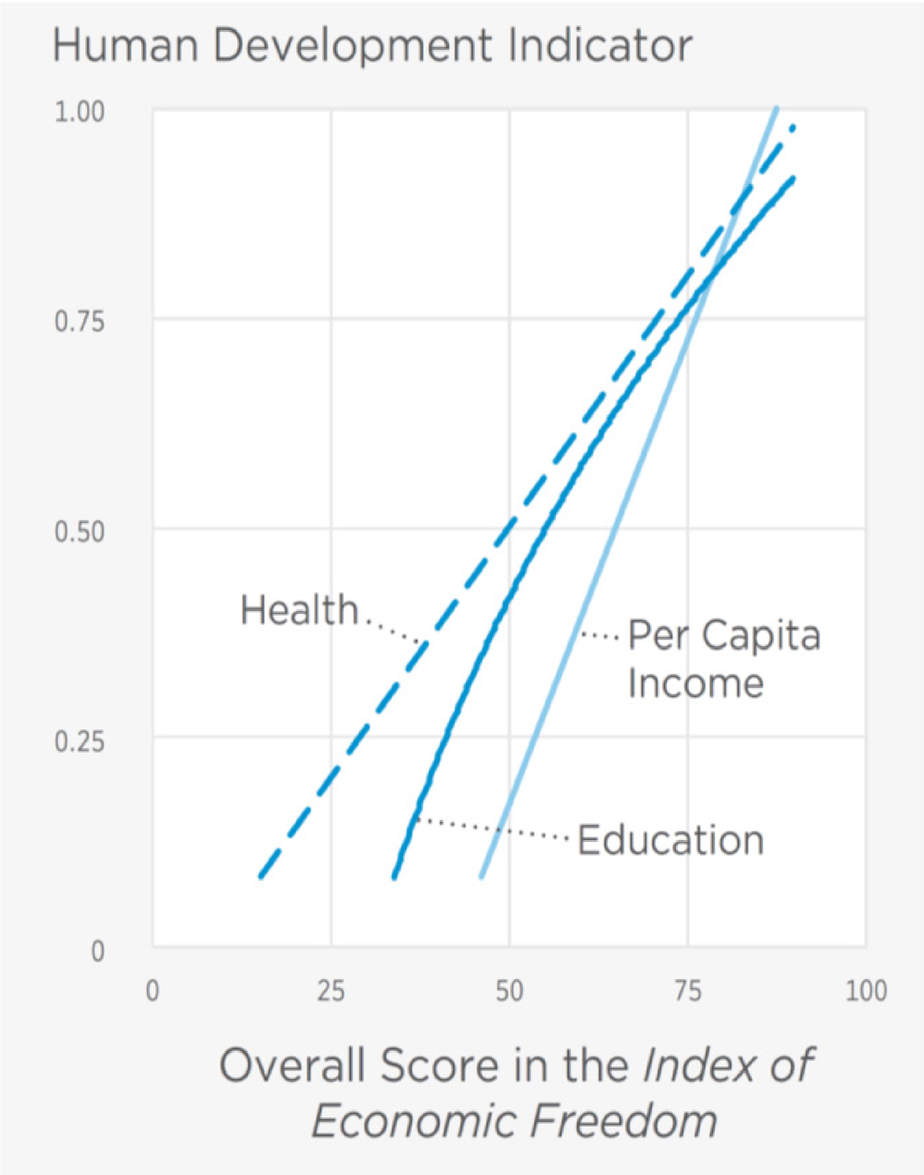
Economic Freedom:
Key to Innovation & Environmental Sustainability





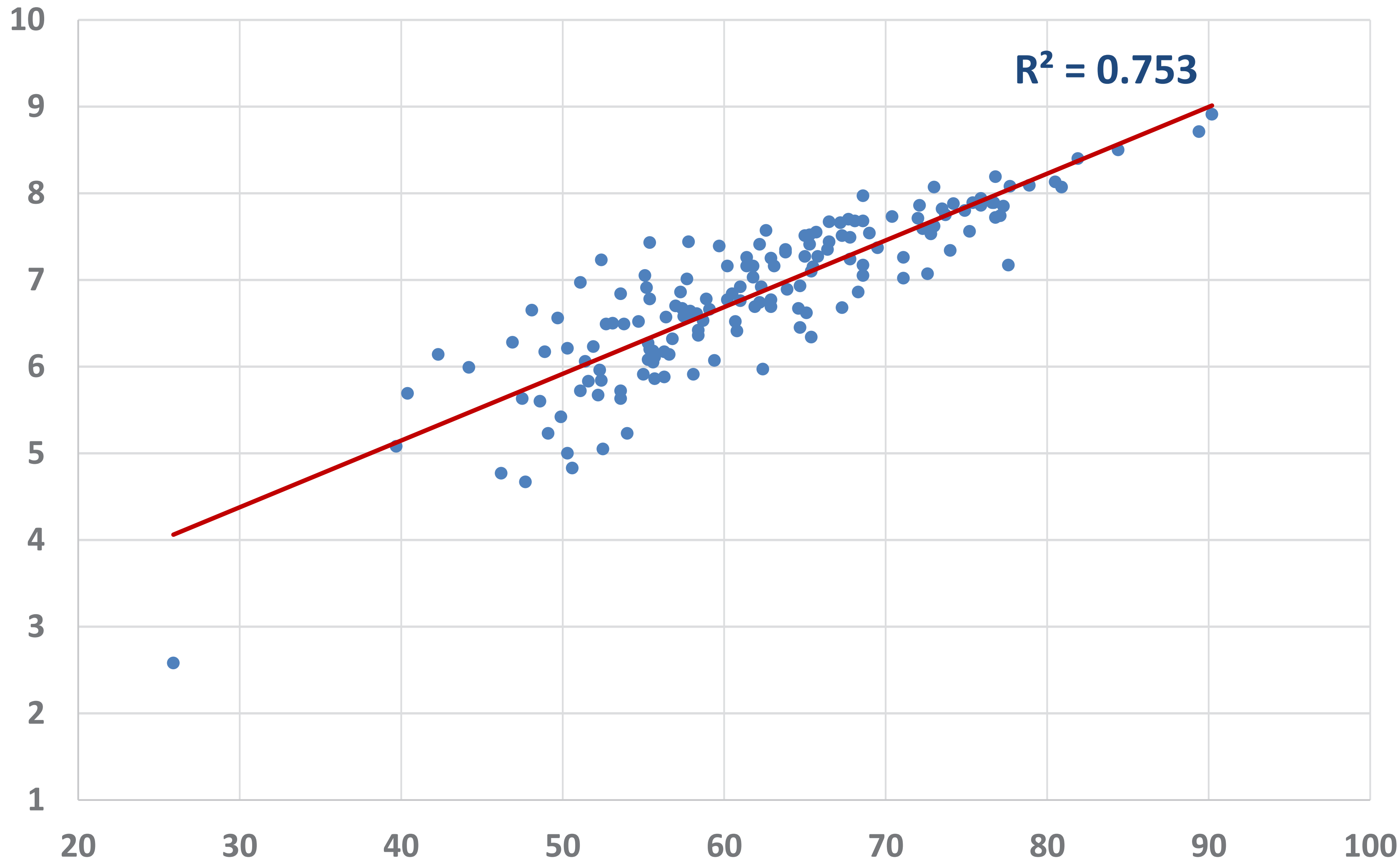
Economic Freedom Matters: Access, Opportunity, and Empowerment



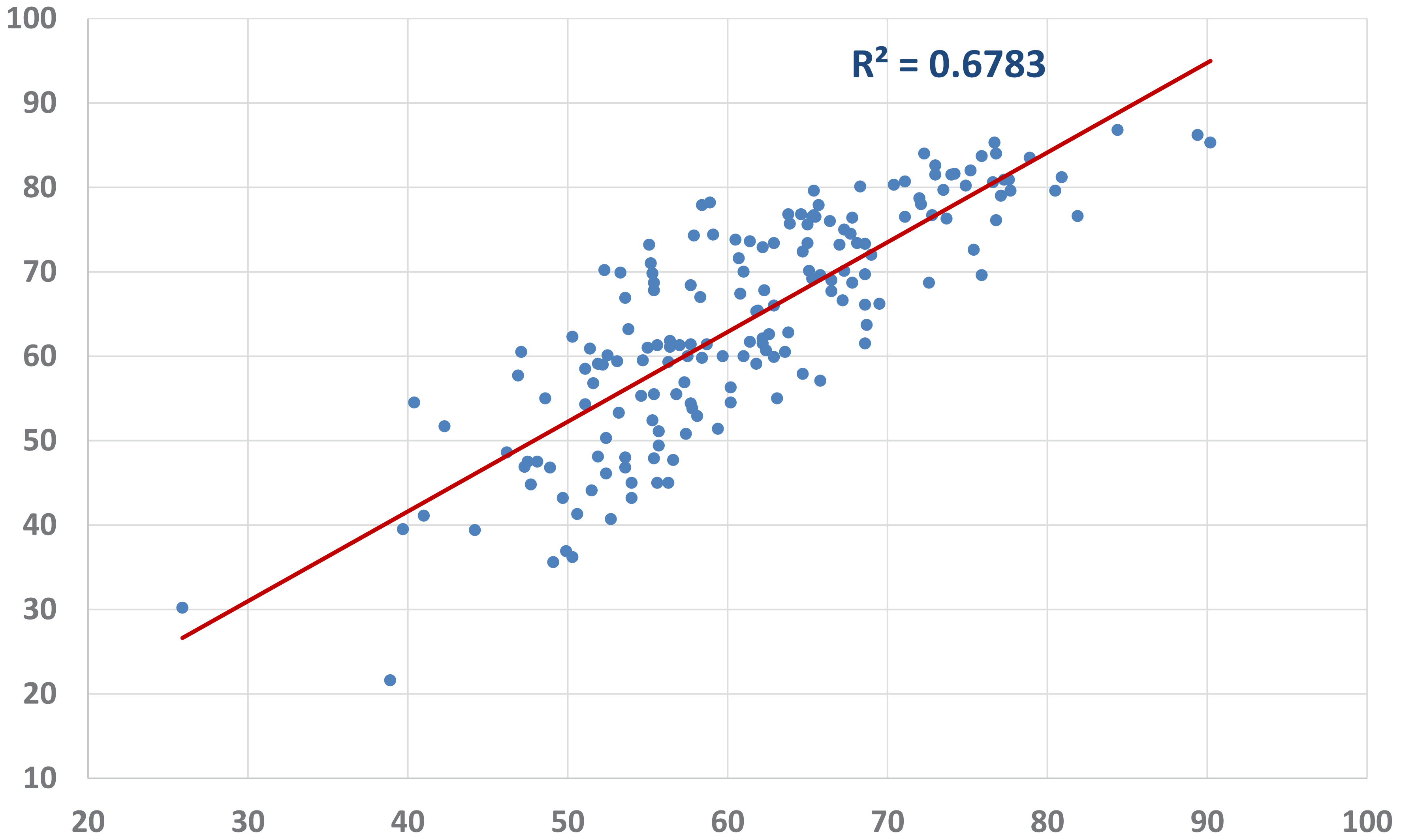


Economic Freedom: Key to Entrepreneurial Dynamism and Democratic Governance

Index of Economic Freedom and Economic Freedom of the World



Economic Freedom and Doing Business



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"Without Heritage, Every Generation Starts Over."

Economic Freedom

Promoting Economic Opportunity and Prosperity

The Heritage Foundation

Anthony Kim
Research Manager and Editor of the Index of Economic Freedom

ANTHONY B. KIM

INDEX OF ECONOMIC FREEDOM

Anthony B. Kim is research manager and editor of the *Index of Economic Freedom*, published annually by the Heritage Foundation. Previously, Kim served as deputy chief of staff to Heritage founder Edwin J. Feulner. Focusing on policies related to economic freedom, entrepreneurship, and investment in various countries around the world, Kim researches international economic issues. The *Index of Economic Freedom* is a widely respected policy guidebook that tracks the march of economic freedom around the world by measuring twelve freedoms—from property rights to entrepreneurship—in 186 countries. In 2007, after publishing the *Index* for a decade, Heritage executives decided that changes were needed to make it more accessible to more readers, from policy makers to investors around the globe. Kim helped oversee and implement those changes.

Kim's commentary and opinion pieces have been published by the *Wall Street Journal*'s Asia edition, the *New York Post*, the *Washington Times*, the *National Review Online* and the *Korea Herald*, among other outlets. He has been quoted by major US and international media, among them the *Financial Times*, Associated Press, Agence France-Presse, Fox Business News, and Voice of America. Kim won Heritage's prestigious Drs. W. Glenn and Rita Ricardo Campbell Award, which goes to the employee who makes "an outstanding contribution to the analysis and promotion of a free society." Before joining Heritage in 2001, Kim studied economics at Rutgers University. He holds a master's degree in international trade and investment policy from the Elliott School of International Affairs at George Washington University.

MPS

1980 | 2020

MONT PELERIN SOCIETY

FROM THE PAST TO THE FUTURE: IDEAS AND ACTIONS FOR A FREE SOCIETY

HOOVER INSTITUTION, STANFORD UNIVERSITY

FRASER INSTITUTE

Economic Freedom: Objective, Transparent Measurement

Fred McMahon
Michael Walker Chair of
Economic Freedom Research
Fraser Institute

What is Economic Freedom

Individuals have economic freedom when property they acquire without the use of force, fraud, or theft is protected from physical invasions by others and they are free to use, exchange, or give their property as long as their actions do not violate the identical rights of others. An index of economic freedom should measure the extent to which rightly acquired property is protected and individuals are engaged in voluntary transactions.

James Gwartney et al. 1996

Components of the Economic Freedom of the World Index

- Size of government and taxation
- Private property and the rule of law
- Sound money
- Trade regulation and tariffs
- Regulation of business, labour and capital markets

What is the Economic Freedom of the World Index?

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- Originated by Michael Walker and Milton and Rose Friedman over 35 years ago in 1984.
- Decade long research phase involved over 60 top scholars in a variety of fields and produced three volumes of studies.
- An annual compilation of data representing 42 variables which determine the economic freedom of a jurisdiction.
- All data are from third party sources for objectivity.
- Fraser has no political affiliation—the focus is on policy not politics. Thus no conflict of political interest in measuring Canada or other nations.
- Transparent formulas are used to manipulate the data.

What's New

- The index includes a Gender Disparity Adjustment, based on 41 variables from the World Bank's gender discrimination data, to recognize women too often do not have the same freedom as men.
- Authors: James Gwartney, Robert Lawson, Joshua Hall, and Ryan Murphy.
- Scoring for many nations projected back to 1950.
- In cooperation with the Atlas Network and the Friedrich Naumann Foundation for freedom, we have conducted economic freedom audits in nearly 20 nations.
- Data now includes historic estimates of economic freedom for 111 countries back to 1950, 113 to1955, 116 to1960, and 118 to 1965 using a newly available dataset.
- Now a collaboration of Institutes in nearly 100 nations and territories.

Why is Economic Freedom Important?

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- Economic rights are fundamental rights in the sense that without them there can be no political freedom or civil freedoms
- They are a prerequisite for growth and development
- They are a prerequisite for broader human development

Importance of objective, transparent measurement

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- We have a great story to tell: the advances in human welfare created by economic freedom.
- However, in an era of fake news and lies accepted as truth (and vice versa), it is essential to be as clear cut and honest as possible.
- The slides to follow tell the human story of economic freedom; you will be familiar with many of the statistics, but I hope to add some value added.

The Age of
Global Free Trade,
Free Market Economies, and
Economic Freedom
Have Brought
Huge Benefits to Humankind

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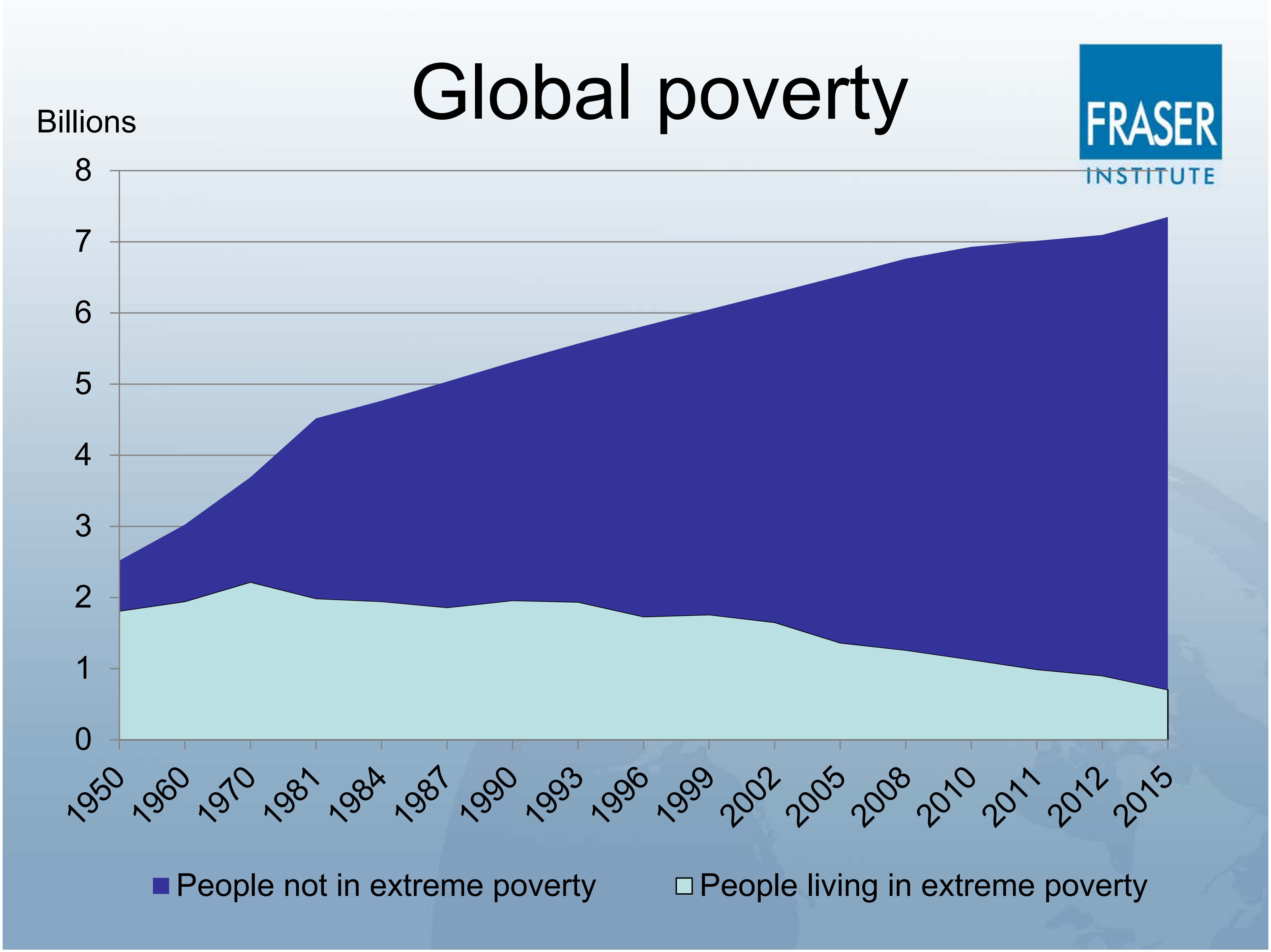
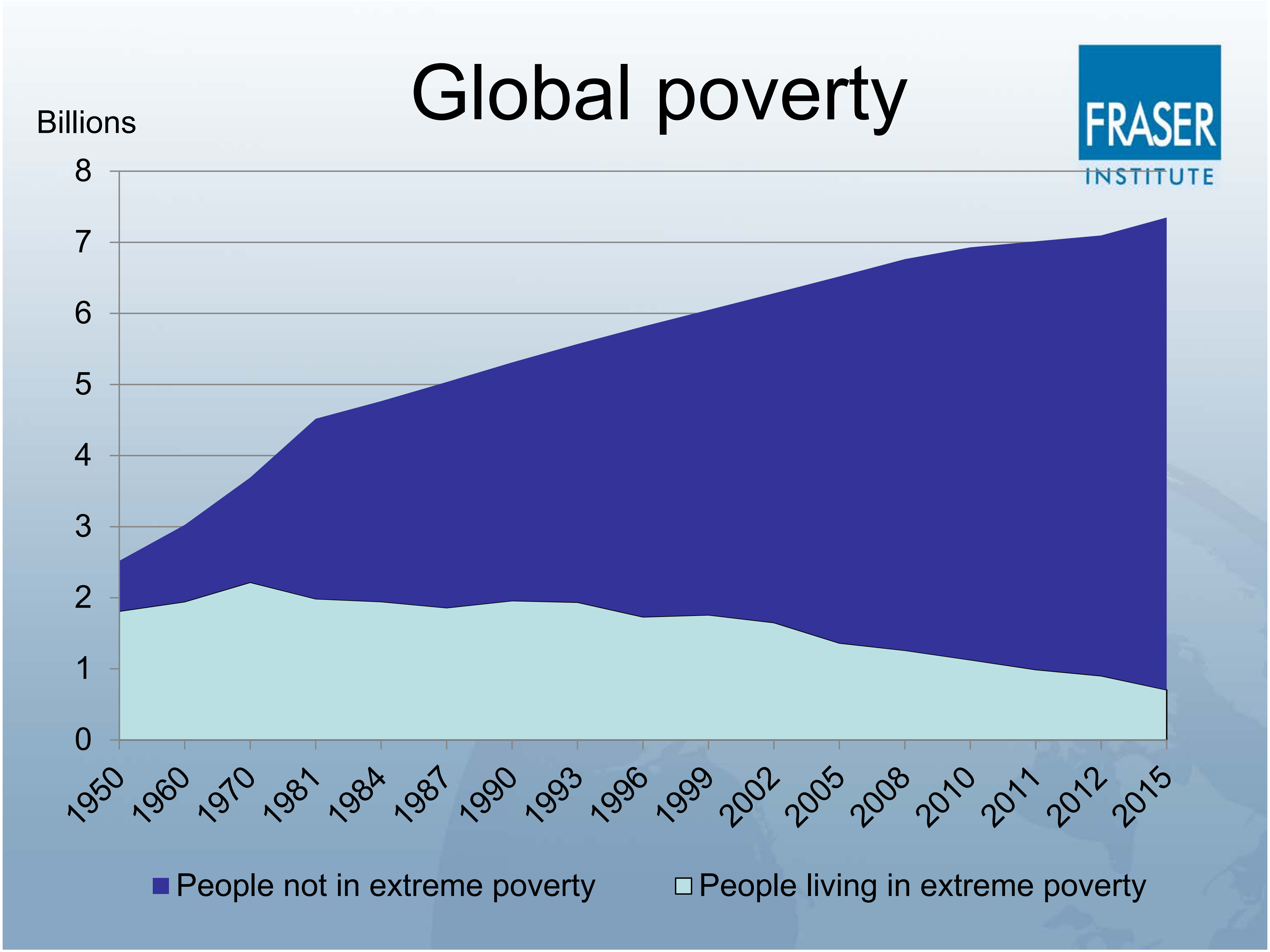


Global poverty
Billions
8
7
6
5
4
3
2
1
0
1950
1960
1970
1981
1984
1987
1990
1993
1996
1999
2002
2005
2008
2010
2011
2012
2015
People not in extreme poverty
People living in extreme poverty
FRASER INSTITUTE

The human condition has improved immensely

While the human condition has improved immensely—in prosperity, health, education, and any number of other good outcomes—only those that live in nations with high levels of economic freedom have fully benefitted. Those in nations with low levels of economic freedom live in conditions often little changed from the 1950s.


Global poverty
Billions
FRASER INSTITUTE
8
7
6
5
4
3
2
1
0
1950
1960
1970
1981
1984
1987
1990
1993
1996
1999
2002
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2008
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2011
2012
2015
People not in extreme poverty
People living in extreme poverty

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FRASER INSTITUTE

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Per capita GDP

Constant US$

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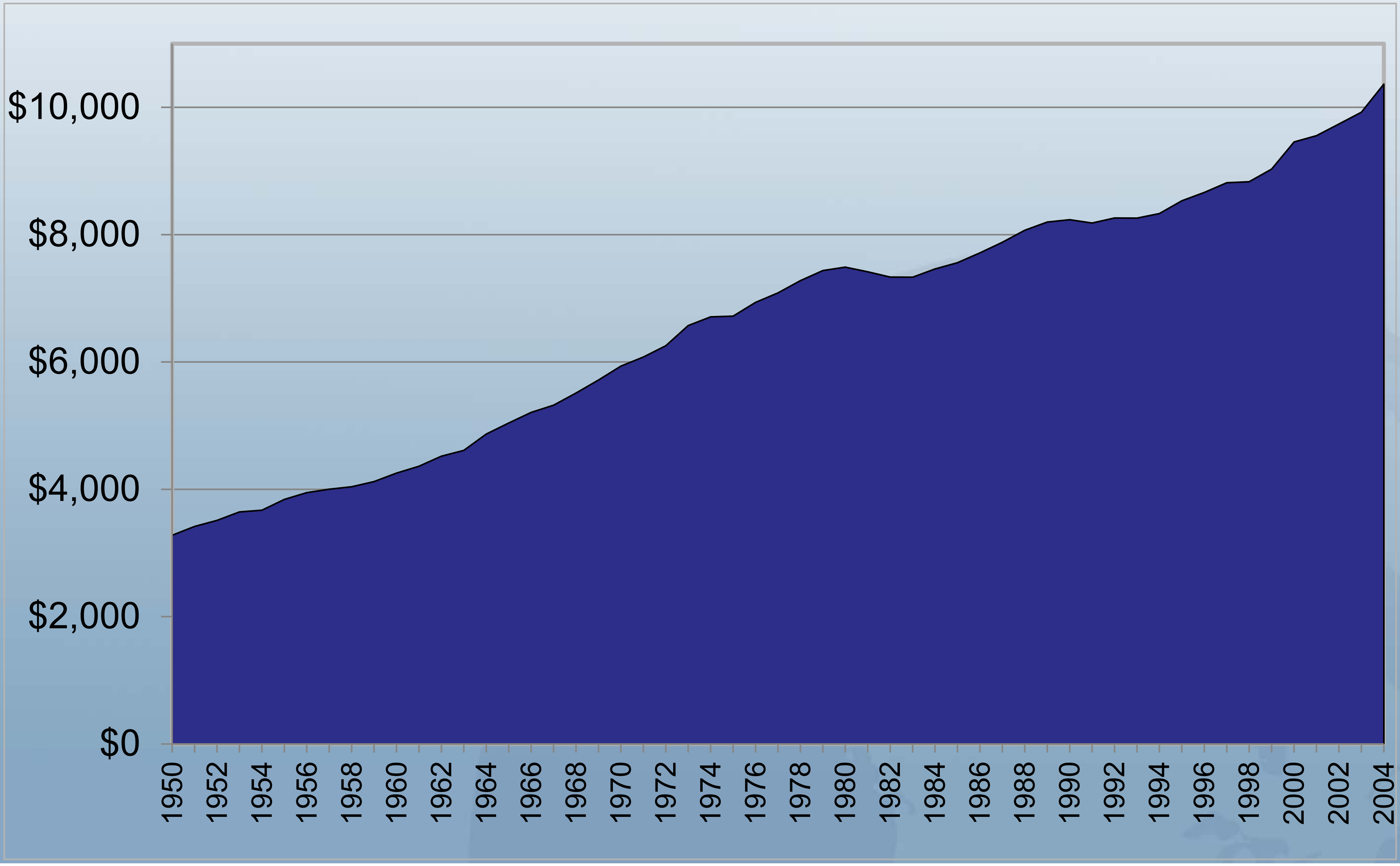
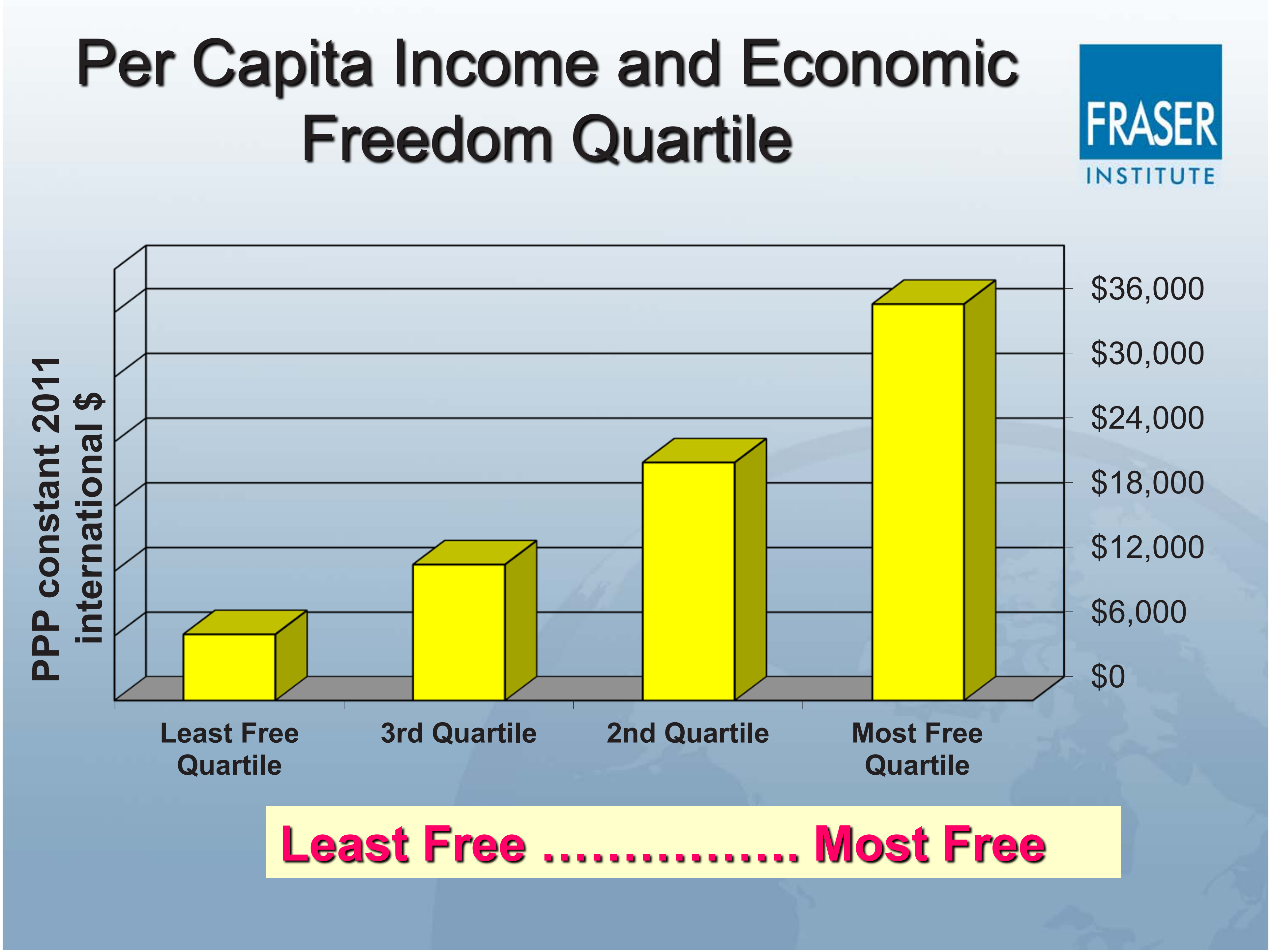
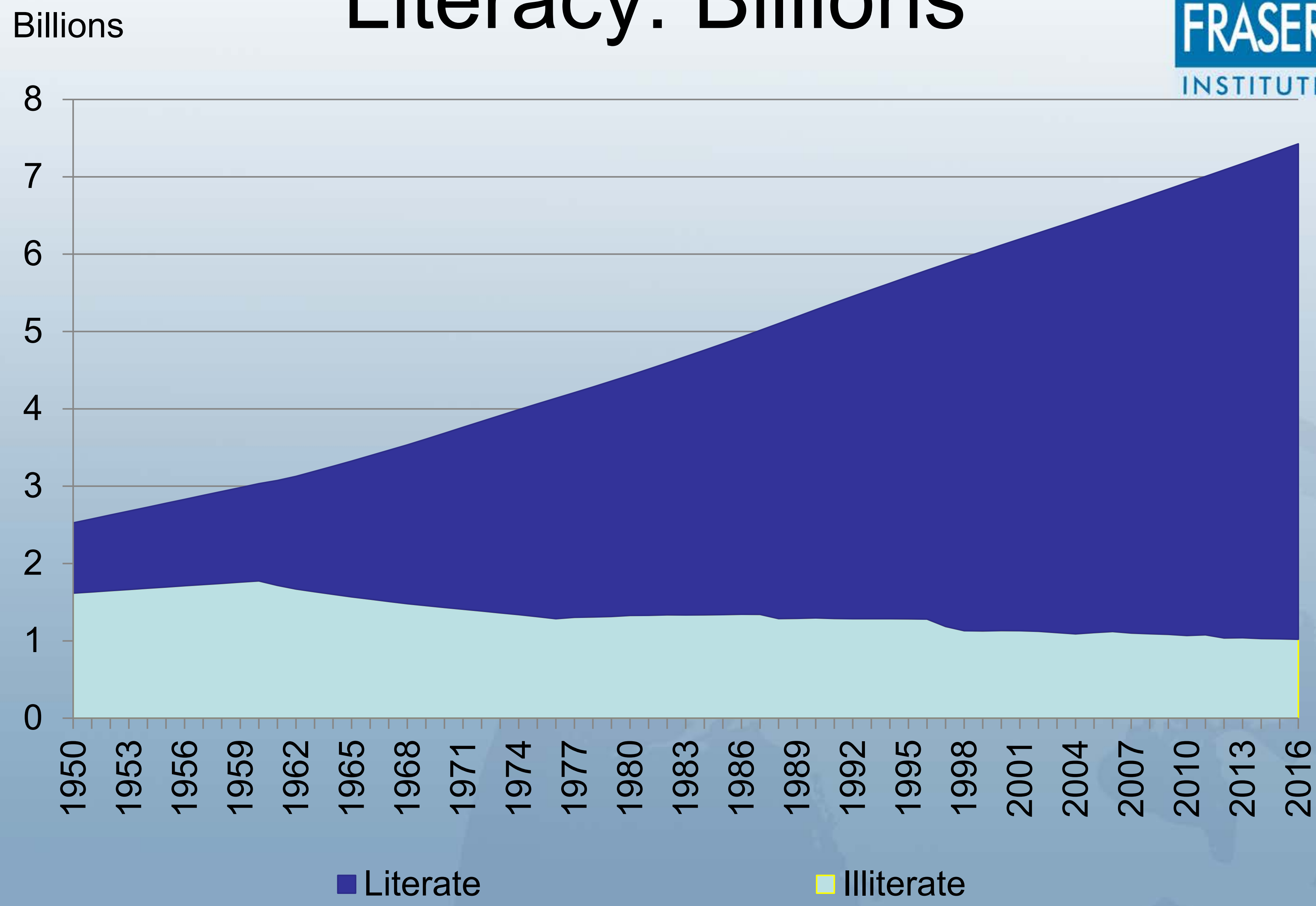
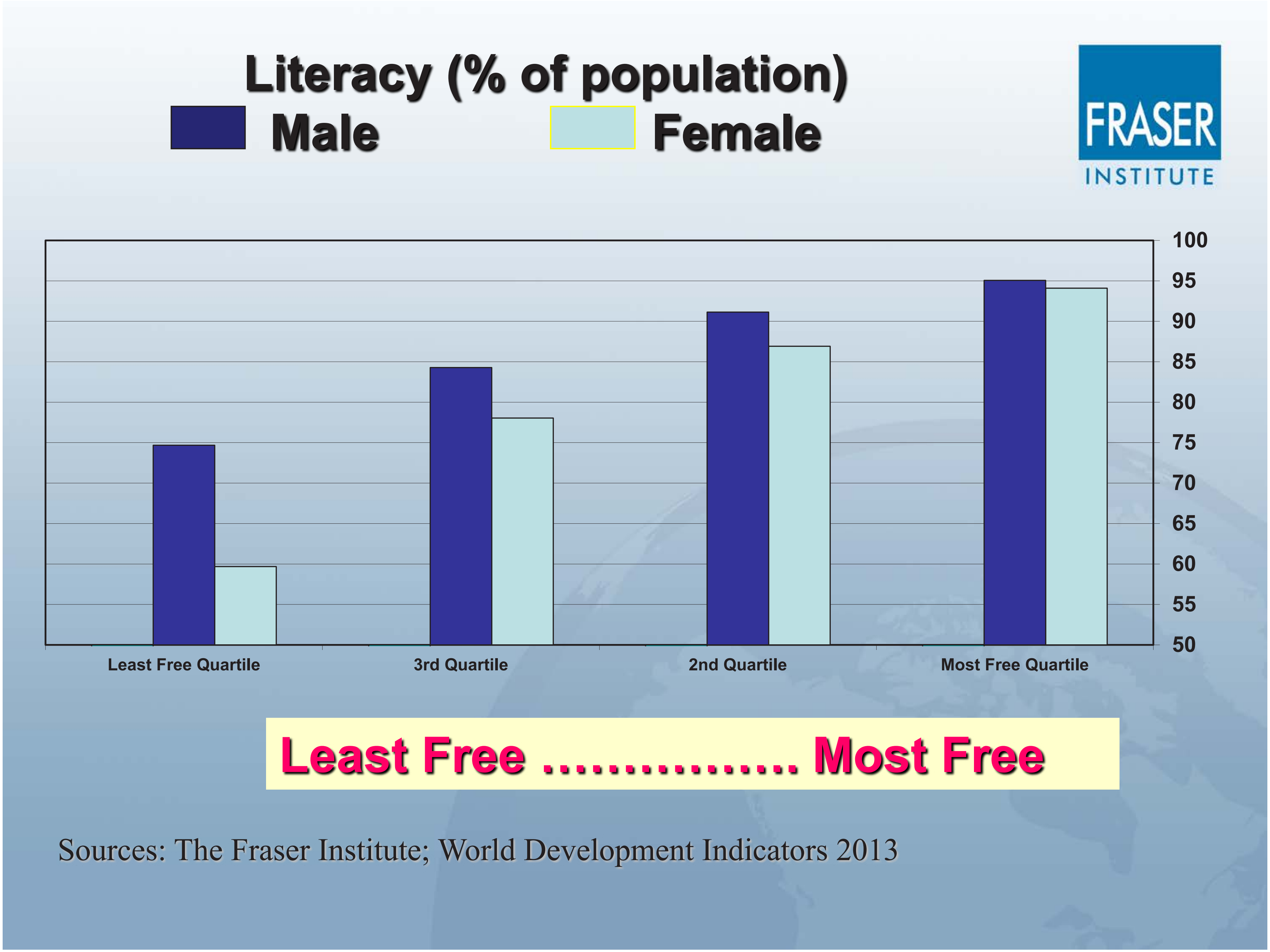


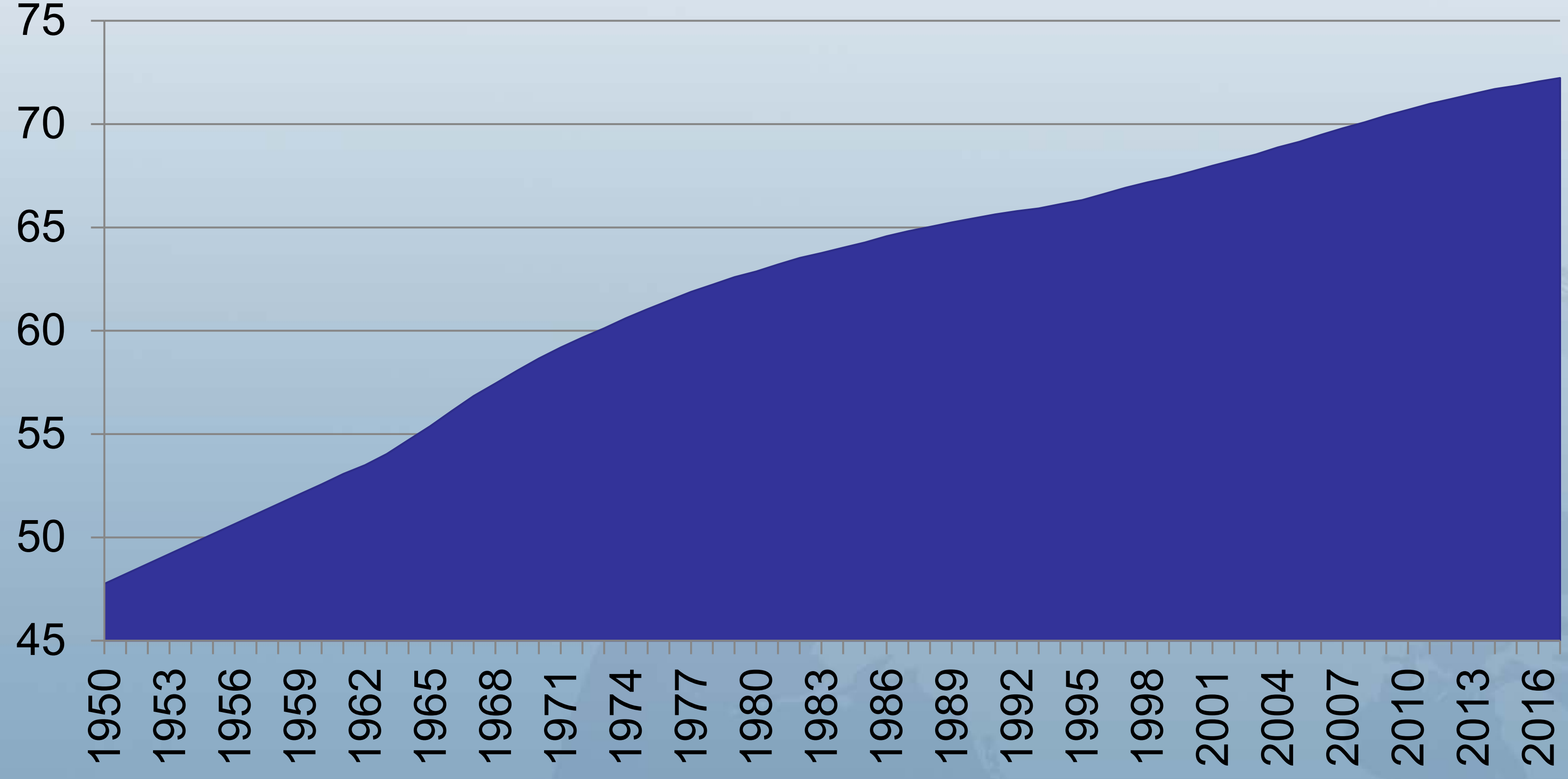

Per Capita Income and Economic Freedom Quartile
FRASER INSTITUTE
PPP constant 2011 international $
$36,000
$30,000
$24,000
$18,000
$12,000
$6,000
$0
Least Free Quartile
3rd Quartile
2nd Quartile
Most Free Quartile
Least Free .... Most Free

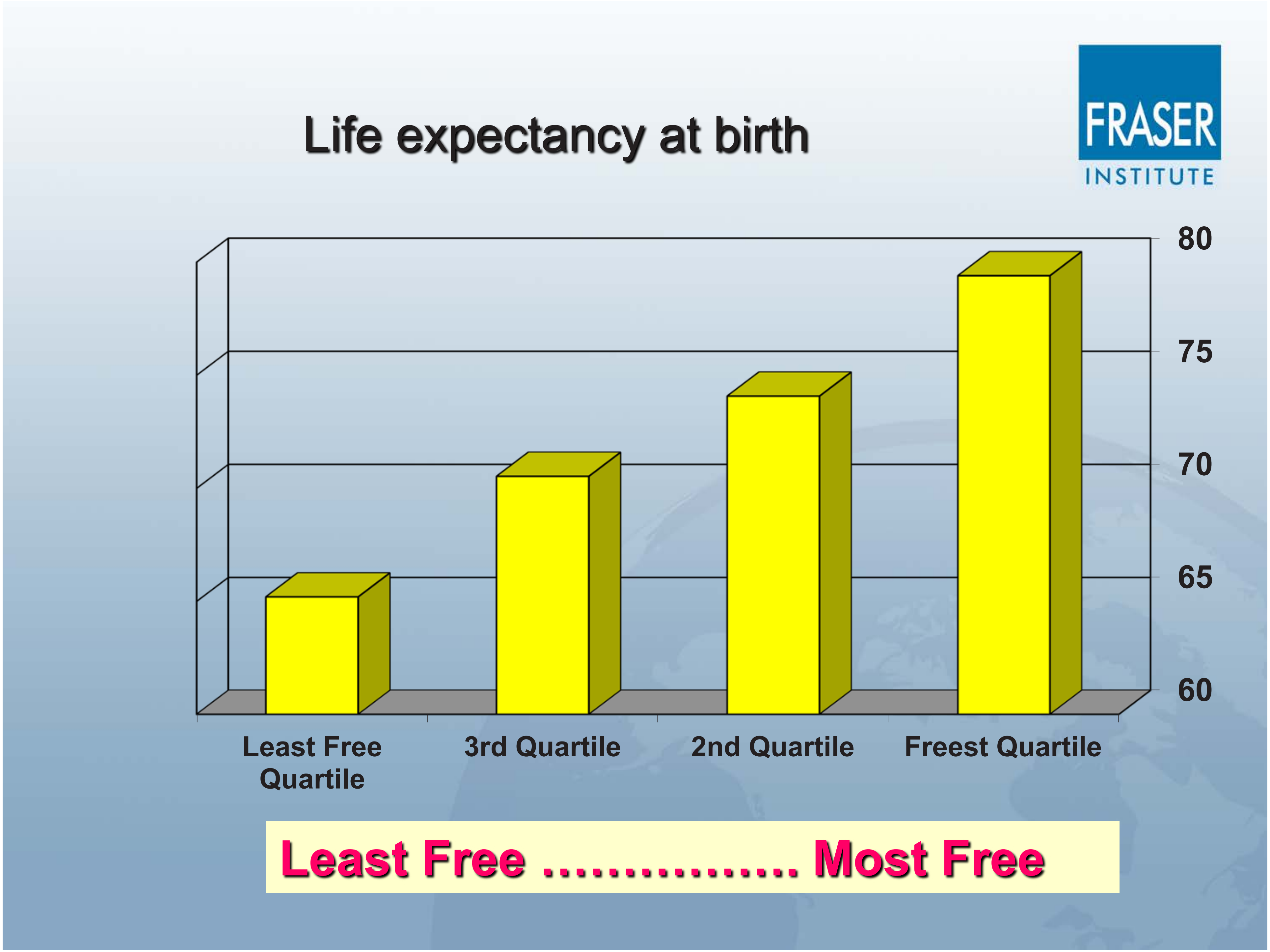
Literacy: Billions




Literacy (% of population)
Male
Female
FRASER
INSTITUTE
100
95
90
85
80
75
70
65
60
55
50
Least Free Quartile
3rd Quartile
2nd Quartile
Most Free Quartile
Least Free ……………… Most Free
Sources: The Fraser Institute; World Development Indicators 2013

Life Expectancy: Years



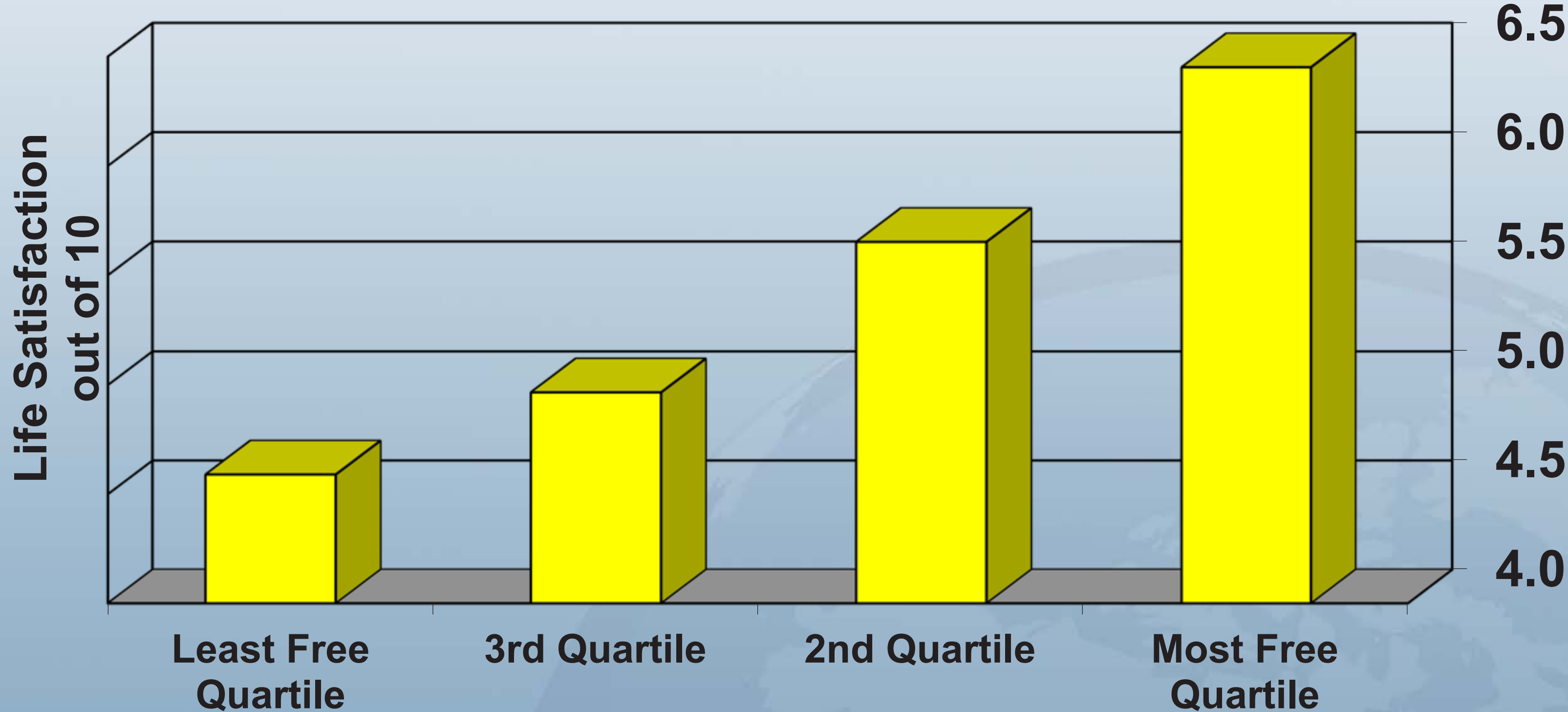

Life expectancy at birth
FRASER INSTITUTE
80
75
70
65
60
Least Free Quartile
3rd Quartile
2nd Quartile
Freest Quartile
Least Free ……………. Most Free

Not just due to time

- In the economically freest nations, the top quarter, only 1.8 percent of the population live in extreme poverty ($1.90 a day) and 5.1 percent in moderate ($3.20 a day) poverty compared to 40.5 percent in extreme poverty and 27.2 percent in moderate poverty in the quarter least free nations.
- Life expectancy is 79 years in the freest nations compared to 65 in the least free nations.
- Average per capita GDP in the freest nations is $36,770 (purchasing power parity adjusted US$) compared to $6,140 in the least free nations.
- Literacy is 95.1 percent among men and 94.1 percent among women in the freest nations but only 64.7 percent and 59.7 respectively in the least free nations, with such outcome gaps between men and women typical comparing free to unfree nations.

One last thing

Economic Freedom and Life Satisfaction



Least Free .... Most Free

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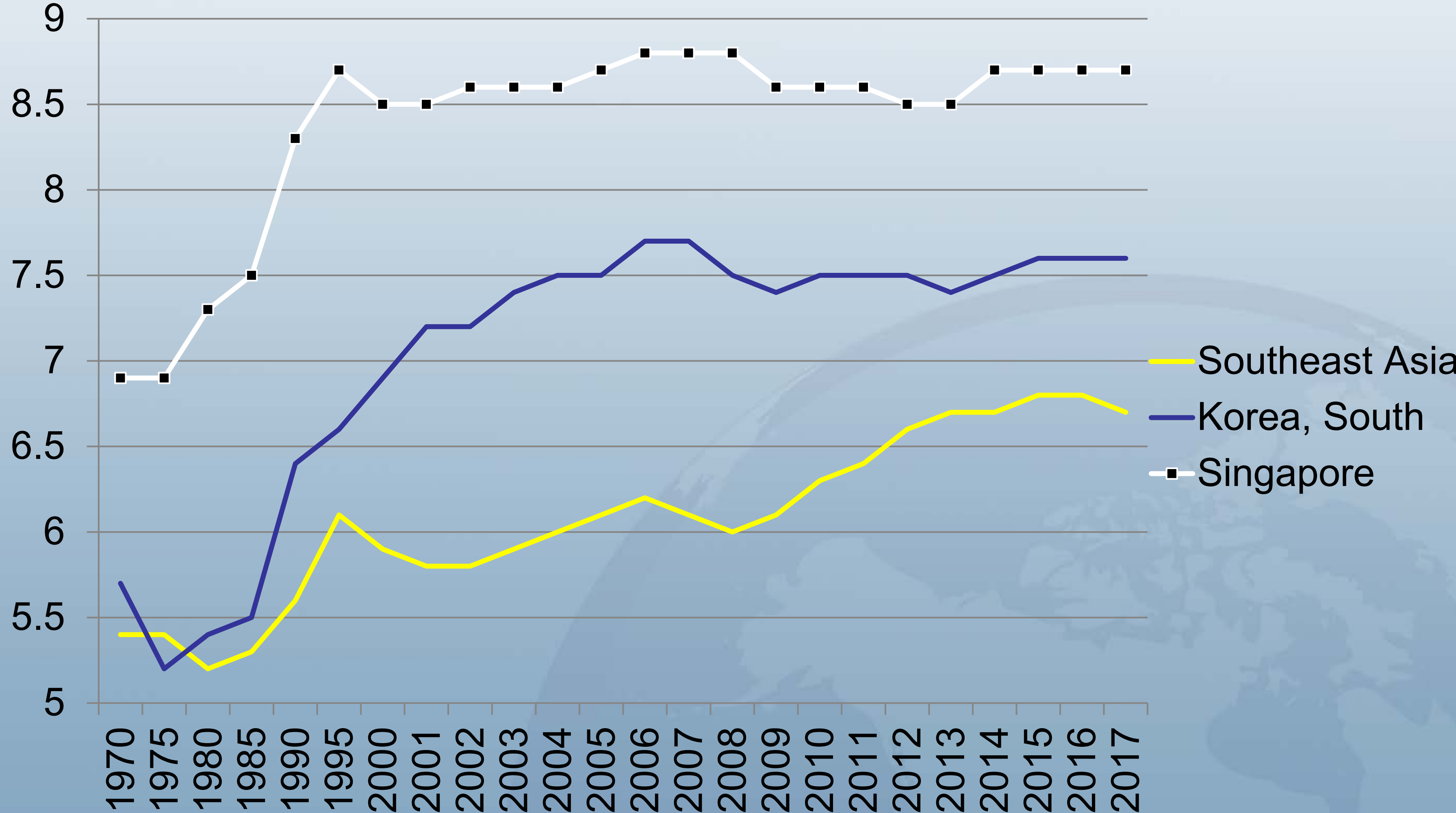
Some of the great longer-term successes

Asia

Economic Freedom Scores



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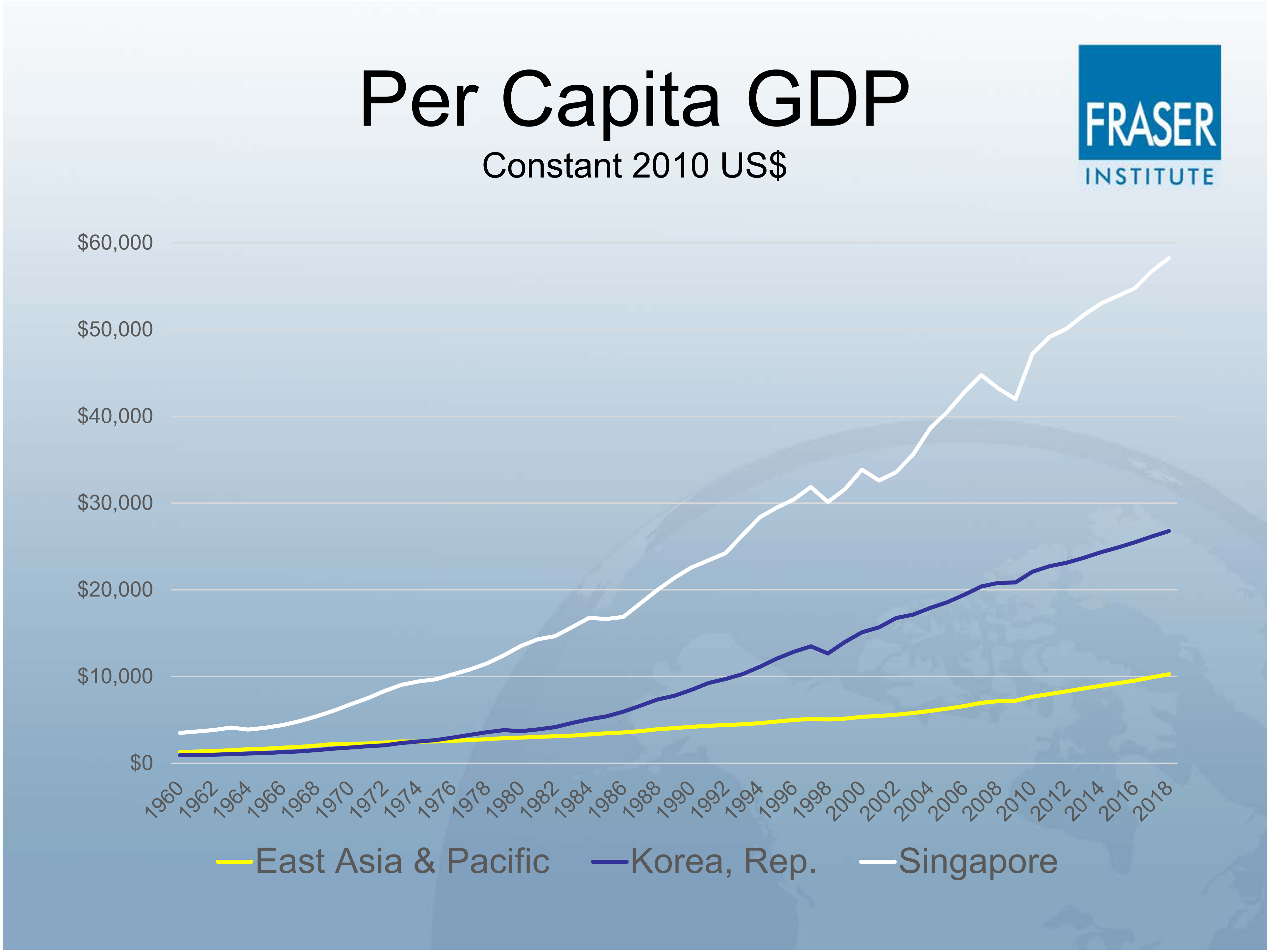
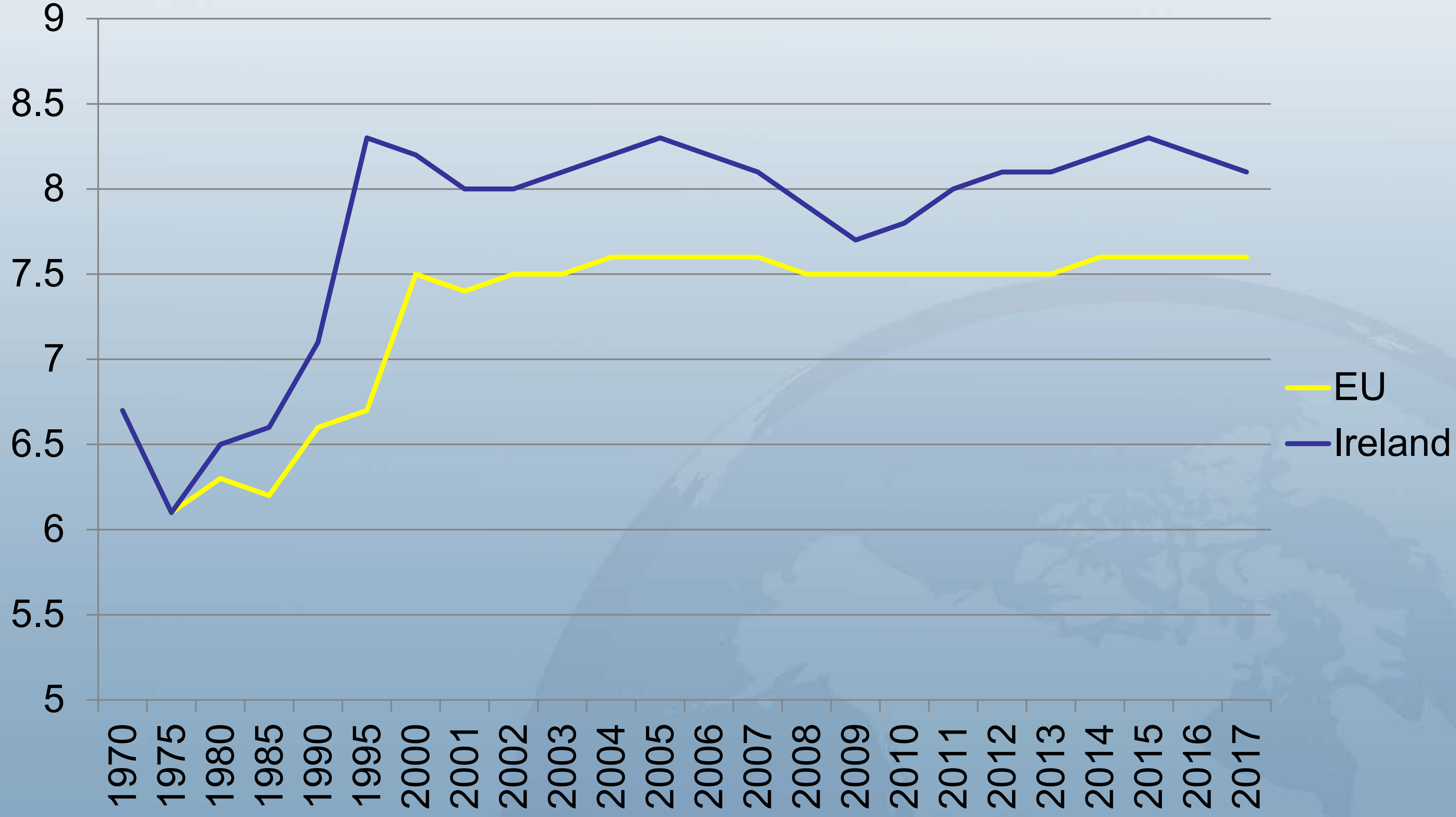
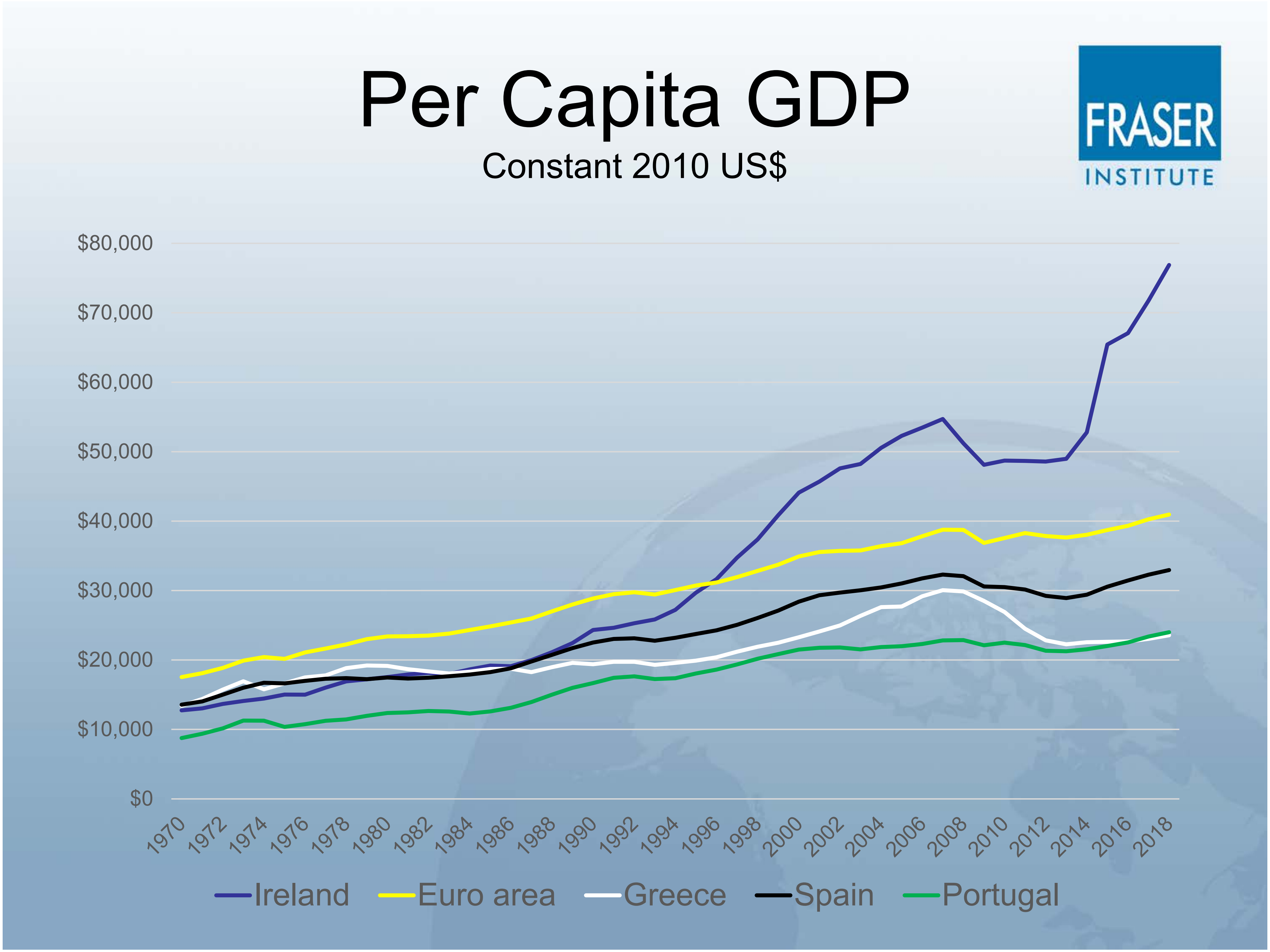


Per Capita GDP
Constant 2010 US$
FRASER INSTITUTE
$60,000
$50,000
$40,000
$30,000
$20,000
$10,000
$0
1960 1962 1964 1966 1968 1970 1972 1974 1976 1978 1980 1982 1984 1986 1988 1990 1992 1994 1996 1998 2000 2002 2004 2006 2008 2010 2012 2014 2016 2018
East Asia & Pacific
Korea, Rep.
Singapore

Europe

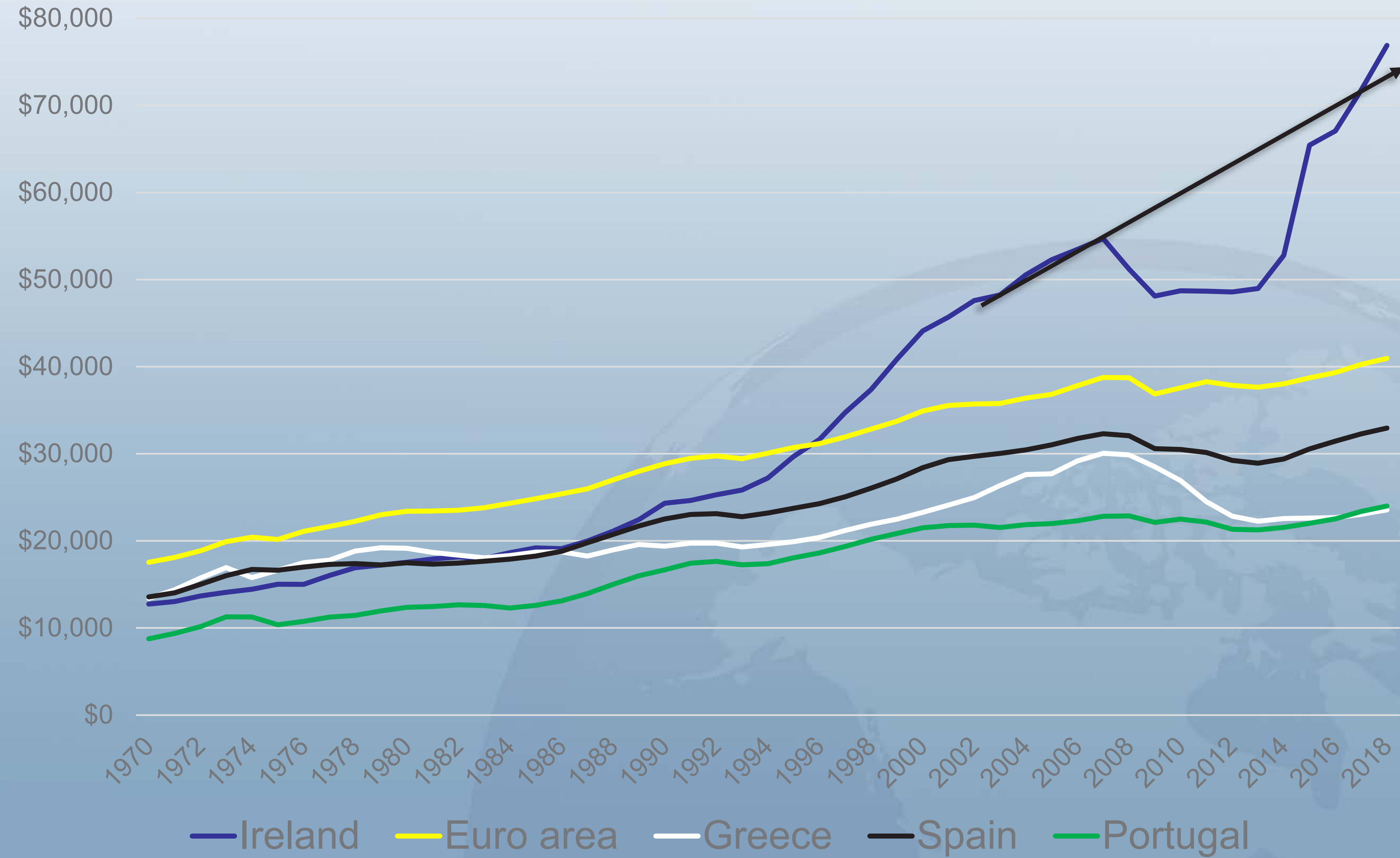
Economic Freedom Scores



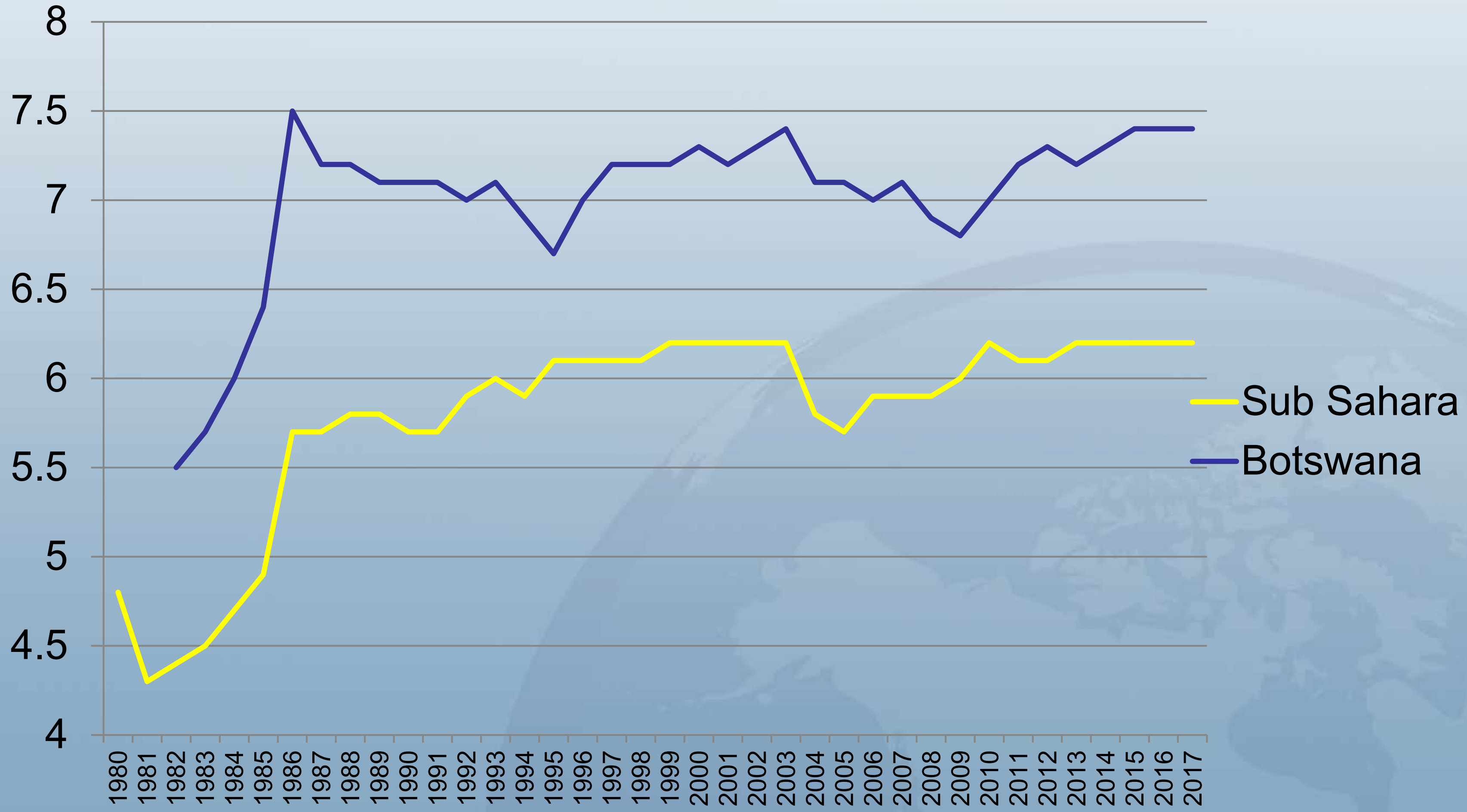

Per Capita GDP
Constant 2010 US$
FRASER
INSTITUTE
$80,000
$70,000
$60,000
$50,000
$40,000
$30,000
$20,000
$10,000
$0
1970
1972
1974
1976
1978
1980
1982
1984
1986
1988
1990
1992
1994
1996
1998
2000
2002
2004
2006
2008
2010
2012
2014
2016
2018
Ireland
Euro area
Greece
Spain
Portugal

Per Capita GDP

Constant 2010 US$

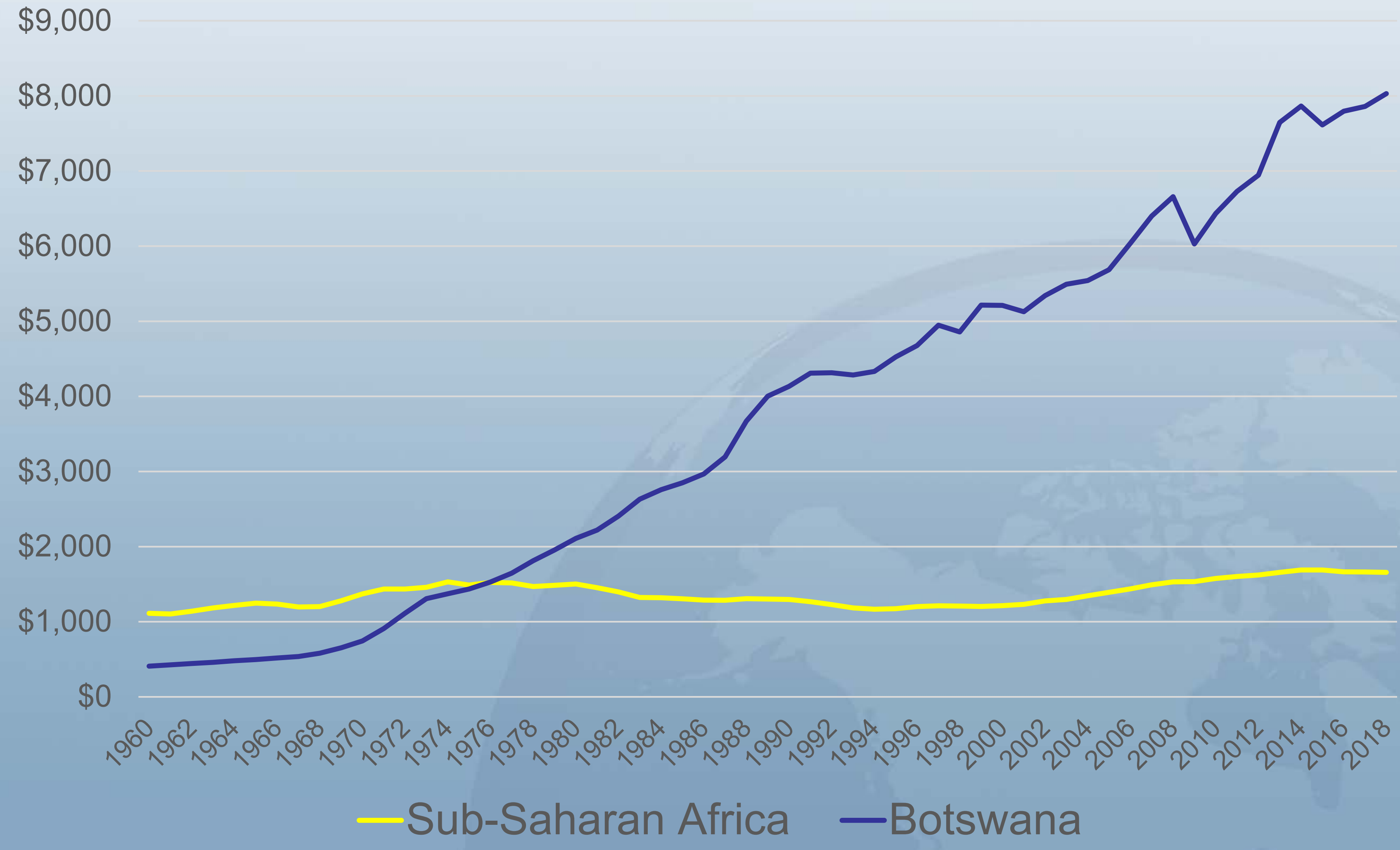


Economic Freedom Score



Per Capita GDP

Constant 2010 US$



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FRED McMAHON

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Fred McMahon is the Dr. Michael A. Walker Research Chair in Economic Freedom at the Fraser Institute in Vancouver, Canada. He manages the Economic Freedom of the World Network, an alliance of think tanks in nearly one hundred nations and territories. The network produces the *Economic Freedom of the World Report*, an annual study that ranks nations on economic liberty.

McMahon is coauthor of *Economic Freedom of the Arab World* and *Economic Freedom of North America*. He has worked on economic reform programs in more than a dozen nations and has authored several books and many articles on economic reform, both academic and in the popular media. His book *Looking the Gift Horse in the Mouth*, about damaging government intervention and spending, won the Sir Antony Fisher Memorial Award.

The World Bank's Doing Business Indicators[1]

Presented at the Mont Pelerin Society 2020 Special Meeting, Hoover Institution

Session on Measures of Economic Freedom

Valeria Perotti, Program Manager, World Bank

The motivation behind the Doing Business indicators

Doing Business is founded on the principle that economic activity benefits from clear rules: rules that allow voluntary exchanges between economic actors, set out strong property rights, facilitate the resolution of commercial disputes, and provide contractual partners with protections against arbitrariness and abuse. Such rules are much more effective in promoting growth and development when they are efficient, transparent, and accessible to those for whom they are intended.

The Doing Business study benchmarks aspects of business regulation and practice using specific case studies with standardized assumptions. Its first edition, published in 2003, was inspired by the work of Peruvian economist Hernando de Soto. In the summer of 1983, a group of researchers working with de Soto went through the process of getting all the permits required to open a small garment business on the outskirts of Lima, with the goal to measure how long this would take. The result was an astonishing 289 days. De Soto's conjecture, which turned out to be right, was that measuring and reporting would create pressure for improvements in the efficiency of government. In 2002, de Soto reported that because of changes to regulations and procedures, the same business could get all the required permits in a single day.

Similar to de Soto's experiment, the Doing Business project aims to provide quantitative indicators on business regulation, to promote reform and support regulatory efficiency and transparency.

What Doing Business measures

Doing Business collects primary data – data that would not otherwise be available to the public. It captures several important dimensions of the regulatory environment affecting domestic firms. It provides quantitative indicators on regulation for starting a business, dealing with construction permits, getting electricity, registering property, getting credit, protecting minority investors, paying taxes, trading across borders, enforcing contracts, and resolving insolvency.

The project uses standardized case studies to provide objective, quantitative measures that can be compared across 190 economies. Most indicators measure quantitative aspects such as the number of

[1] The content of this note is an adaptation from the World Bank's *Doing Business 2020* report, available at http://www.doingbusiness.org/reports.

procedures required, and the time and cost associated with such procedures. The indicators also measure aspects of regulatory quality by benchmarking laws and regulations against recognized good practices.

Table 1 – What is included in the ease of doing business ranking

Indicator set	What is measured
Starting a business	Procedures, time, cost, and paid-in minimum capital to start a limited liability company for men and women
Dealing with construction permits	Procedures, time, and cost to complete all formalities to build a warehouse and the quality control and safety mechanisms in the construction permitting system
Getting electricity	Procedures, time, and cost to get connected to the electrical grid; the reliability of the electricity supply; and the transparency of tariffs
Registering property	Procedures, time, and cost to transfer a property and the quality of the land administration system for men and women
Getting credit	Movable collateral laws and credit information systems
Protecting minority investors	Minority shareholders' rights in related-party transactions and in corporate governance
Paying taxes	Payments, time, and total tax and contribution rate for a firm to comply with all tax regulations as well as postfiling processes
Trading across borders	Time and cost to export the product of comparative advantage and to import auto parts
Enforcing contracts	Time and cost to resolve a commercial dispute and the quality of judicial processes for men and women
Resolving insolvency	Time, cost, outcome, and recovery rate for a commercial insolvency and the strength of the legal framework for insolvency

Ensuring comparability of the data across a global set of economies is a central consideration for the Doing Business indicators, which are developed using standardized case scenarios with specific assumptions. For example, the standardized business described in the case scenario is located in the largest business city of the economy.[2] Further, the firm described in the case scenario is typically a small- to medium-sized limited liability company (or its equivalent legal form). Entrepreneurs are assumed to have complete information and to comply with all regulations. The reality is that business regulations and their enforcement may differ within a country, particularly in federal states and large economies.

Doing Business presents data both for individual indicators and for two aggregate measures: the ease of doing business score and the ease of doing business ranking.

The individual indicator scores range between 0 and 100, showing the proximity of each economy to the best regulatory performance observed in each of the topics across all economies in the Doing Business sample since 2005 (or the third year in which data were collected for the indicator). The scores (and rankings) of each economy vary considerably across topics, indicating that a strong performance by an economy in one area of regulation can coexist with weak performance in another.

Doing Business uses a simple averaging approach for weighting component indicators, calculating rankings, and determining the ease of doing business score. The ease of doing business score is obtained by a simple average of the individual indicators, first by topic and then across the 10 topics, and it shows

[2] For 11 economies with population larger than 100 million, the second largest business city is also measured.

an economy's position relative to the best regulatory performance. The ease of doing business ranking is based on the aggregate ease of doing business score and it is an indication of an economy's position relative to that of other economies.

How Doing Business data are collected

The Doing Business data are based on a detailed reading of domestic laws, regulations, and administrative requirements as well as their implementation in practice as experienced by private professionals. The data are collected through several rounds of communication with expert respondents (both private sector practitioners and government officials), through responses to questionnaires, conference calls, written correspondence, and visits by the team.

More than 48,000 professionals in 190 economies have assisted in providing the data that inform the Doing Business indicators over the past 17 years. Doing Business 2020 draws on the inputs of more than 15,000 professionals.

How Doing Business data have been used in academic research on business regulations

The design of the Doing Business indicators has been informed by theoretical insights from academic research. Background papers developing the methodology for most of the Doing Business indicator sets have established the importance of the rules and regulations that Doing Business measures for economic outcomes such as trade volumes, foreign direct investment, market capitalization in stock exchanges, and private credit as a percentage of GDP (Djankov et al. 2008, 2010, 2007).[3]

More recent results have shown that greater ease of doing business is associated with higher new business density (Divanbeigi and Ramalho 2015; Djankov et al. 2018), and lower levels of income inequality. Further, the ease of doing business matters for growth: moving from the lowest quartile of improvement in business regulations to the highest quartile is associated with a significant increase in annual per capita growth of around 0.8 percentage points (Divanbeigi and Ramalho 2015).

Academic researchers have been using the Doing Business data across the different dimensions measured. As an example:

- Improved business friendly regulations are highly correlated with reduced poverty headcount (Djankov et al. 2018);

[3] For a full list of research papers supporting the Doing Business methodology, please see: https://www.doingbusiness.org/en/methodology.

- Firms in economies with higher branch penetration and better credit information sharing have stronger incentives to operate formally (Beck et al. 2014);
- The introduction of collateral registries for movable assets is associated with increased access to finance (Love et al. 2016).
- Tax simplification helps to expand the formal economy (Monteiro and Assunção 2012), while tax complexity is associated with fewer—but not smaller—foreign direct investments (Lawless 2013).

Promoting reform

The World Bank's Doing Business team regularly engages with governments to gather information on regulatory changes, and to provide information on the study's methodology and results. In the last data collection cycle, these stakeholder engagements included 36 data collection missions, 51 visiting government delegations, and videoconferences with representatives of 103 economies.

The Doing Business report is widely read (200,000 downloads for the latest edition) and its results are followed closely by government representatives (Economist, 2019).

Consistent with de Soto's conjecture, many reforms have been recorded in the areas measured by Doing Business. Only between May 2018 and May 2019, 294 regulatory reforms were implemented by 115 economies that made it easier to do business. There were also 26 economies that became less business-friendly, introducing 31 regulatory changes that stifled efficiency and quality of regulation.

For one of the first indicators introduced by Doing Business, the starting a business indicator set, 178 economies have implemented 722 reforms since 2003/04, either reducing or eliminating barriers to entry.

Top performers and top reformers in Doing Business 2020

Economies that score highest on the ease of doing business share several common features, including the widespread use of electronic systems. All of the 20 top-ranking economies have online business incorporation processes, have electronic tax filing platforms, and allow online procedures related to property transfers. Moreover, 11 economies have electronic procedures for construction permitting. In general, the 20 top performers have sound business regulation with a high degree of transparency. The average scores of these economies are 12.2 (out of 15) on the building quality control index, 7.2 (out of 8) on the reliability of supply and transparency of tariffs index, 24.8 (out of 30) on the quality of land administration index, and 13.2 (out of 18) on the quality of judicial processes index. Fourteen of the 20 top performers have a unified collateral registry, and 14 allow a viable business to continue operating as a going concern during insolvency proceedings.

Table 2 – Ease of doing business ranking.

Rank	Economy	DB score	Rank	Economy	DB score	Rank	Economy	DB score
1	New Zealand	86.8	65	Puerto Rico (U.S.)	70.1	128	Barbados	57.9
2	Singapore	86.2	66	Brunei Darussalam	70.1	129	Ecuador	57.7
3	Hong Kong SAR, China	85.3	67	Colombia	70.1	130	St. Vincent and the Grenadines	57.1
4	Denmark	85.3	68	Oman	70.0	131	Nigeria	56.9
5	Korea, Rep.	84.0	69	Uzbekistan	69.9	132	Niger	56.8
6	United States	84.0	70	Vietnam	69.8	133	Honduras	56.3
7	Georgia	83.7	71	Jamaica	69.7	134	Guyana	55.5
8	United Kingdom	83.5	72	Luxembourg	69.6	135	Belize	55.5
9	Norway	82.6	73	Indonesia	69.6	136	Solomon Islands	55.3
10	Sweden	82.0	74	Costa Rica	69.2	137	Cabo Verde	55.0
11	Lithuania	81.6	75	Jordan	69.0	138	Mozambique	55.0
12	Malaysia	81.5	76	Peru	68.7	139	St. Kitts and Nevis	54.6
13	Mauritius	81.5	77	Qatar	68.7	140	Zimbabwe	54.5
14	Australia	81.2	78	Tunisia	68.7	141	Tanzania	54.5
15	Taiwan, China	80.9	79	Greece	68.4	142	Nicaragua	54.4
16	United Arab Emirates	80.9	80	Kyrgyz Republic	67.8	143	Lebanon	54.3
17	North Macedonia	80.7	81	Mongolia	67.8	144	Cambodia	53.8
18	Estonia	80.6	82	Albania	67.7	145	Palau	53.7
19	Latvia	80.3	83	Kuwait	67.4	146	Grenada	53.4
20	Finland	80.2	84	South Africa	67.0	147	Maldives	53.3
21	Thailand	80.1	85	Zambia	66.9	148	Mali	52.9
22	Germany	79.7	86	Panama	66.6	149	Benin	52.4
23	Canada	79.6	87	Botswana	66.2	150	Bolivia	51.7
24	Ireland	79.6	88	Malta	66.1	151	Burkina Faso	51.4
25	Kazakhstan	79.6	89	Bhutan	66.0	152	Mauritania	51.1
26	Iceland	79.0	90	Bosnia and Herzegovina	65.4	153	Marshall Islands	50.9
27	Austria	78.7	91	El Salvador	65.3	154	Lao PDR	50.8
28	Russian Federation	78.2	92	San Marino	64.2	155	Gambia, The	50.3
29	Japan	78.0	93	St. Lucia	63.7	156	Guinea	49.4
30	Spain	77.9	94	Nepal	63.2	157	Algeria	48.6
31	China	77.9	95	Philippines	62.8	158	Micronesia, Fed. Sts.	48.1
32	France	76.8	96	Guatemala	62.6	159	Ethiopia	48.0
33	Turkey	76.8	97	Togo	62.3	160	Comoros	47.9
34	Azerbaijan	76.7	98	Samoa	62.1	161	Madagascar	47.7
35	Israel	76.7	99	Sri Lanka	61.8	162	Suriname	47.5
36	Switzerland	76.6	100	Seychelles	61.7	163	Sierra Leone	47.5
37	Slovenia	76.5	101	Uruguay	61.5	164	Kiribati	46.9
38	Rwanda	76.5	102	Fiji	61.5	165	Myanmar	46.8
39	Portugal	76.5	103	Tonga	61.4	166	Burundi	46.8
40	Poland	76.4	104	Namibia	61.4	167	Cameroon	46.1
41	Czech Republic	76.3	105	Trinidad and Tobago	61.3	168	Bangladesh	45.0
42	Netherlands	76.1	106	Tajikistan	61.3	169	Gabon	45.0
43	Bahrain	76.0	107	Vanuatu	61.1	170	São Tomé and Príncipe	45.0
44	Serbia	75.7	108	Pakistan	61.0	171	Sudan	44.8
45	Slovak Republic	75.6	109	Malawi	60.9	172	Iraq	44.7
46	Belgium	75.0	110	Côte d'Ivoire	60.7	173	Afghanistan	44.1
47	Armenia	74.5	111	Dominica	60.5	174	Guinea-Bissau	43.2
48	Moldova	74.4	112	Djibouti	60.5	175	Liberia	43.2
49	Belarus	74.3	113	Antigua and Barbuda	60.3	176	Syrian Arab Republic	42.0
50	Montenegro	73.8	114	Egypt, Arab Rep.	60.1	177	Angola	41.3
51	Croatia	73.6	115	Dominican Republic	60.0	178	Equatorial Guinea	41.1
52	Hungary	73.4	116	Uganda	60.0	179	Haiti	40.7
53	Morocco	73.4	117	West Bank and Gaza	60.0	180	Congo, Rep.	39.5
54	Cyprus	73.4	118	Ghana	60.0	181	Timor-Leste	39.4
55	Romania	73.3	119	Bahamas, The	59.9	182	Chad	36.9
56	Kenya	73.2	120	Papua New Guinea	59.8	183	Congo, Dem. Rep.	36.2
57	Kosovo	73.2	121	Eswatini	59.5	184	Central African Republic	35.6
58	Italy	72.9	122	Lesotho	59.4	185	South Sudan	34.6
59	Chile	72.6	123	Senegal	59.3	186	Libya	32.7
60	Mexico	72.4	124	Brazil	59.1	187	Yemen, Rep.	31.8
61	Bulgaria	72.0	125	Paraguay	59.1	188	Venezuela, RB	30.2
62	Saudi Arabia	71.6	126	Argentina	59.0	189	Eritrea	21.6
63	India	71.0	127	Iran, Islamic Rep.	58.5	190	Somalia	20.0
64	Ukraine	70.2						

More than half of the economies in the top-20 cohort are from the OECD high-income group; however, the top-20 list also includes four economies from East Asia and the Pacific, two from Europe and Central Asia, as well as one from the Middle East and North Africa and one from Sub-Saharan Africa. Conversely, most economies (12) in the bottom 20 are from the Sub-Saharan Africa region. Encouragingly, several of the lowest-ranked economies are actively reforming in pursuit of a better business environment. In contrast to the economies ranked in the top 20, however, the bottom 20 implemented only 10 reforms in 2018/19.

The economies with the most notable improvement in Doing Business 2020 are Saudi Arabia, Jordan, Togo, Bahrain, Tajikistan, Pakistan, Kuwait, China, India, and Nigeria. These economies implemented a total of 59 regulatory reforms in 2018/19—accounting for one-fifth of all the reforms recorded worldwide. Their efforts focused primarily on the areas of starting a business, dealing with construction permits, and trading across borders.

Table 3 – The 10 economies improving the most across three or more areas measured by Doing Business in 2018-19.

Economy	Ease of doing business rank	Change in ease of doing business score	Reforms making it easier to do business									
			Starting a business	Dealing with construction permits	Getting electricity	Registering property	Getting credit	Protecting minority investors	Paying taxes	Trading across borders	Enforcing contracts	Resolving insolvency
Saudi Arabia	62	7.7	✔	✔	✔		✔	✔		✔	✔	✔
Jordan	75	7.6					✔		✔			✔
Togo	97	7.0	✔	✔	✔	✔	✔					
Bahrain	43	5.9		✔	✔	✔	✔	✔	✔	✔	✔	✔
Tajikistan	106	5.7	✔				✔			✔		
Pakistan	108	5.6	✔	✔	✔	✔			✔	✔		
Kuwait	83	4.7	✔	✔	✔	✔	✔	✔		✔		
China	31	4.0	✔	✔	✔			✔	✔	✔	✔	✔
India	63	3.5	✔	✔						✔		✔
Nigeria	131	3.4	✔	✔	✔	✔				✔	✔	

What is next

After some early rounds of pilot data collection, the Doing Business project has been collecting data on the efficiency of public procurement since 2017, and is planning on introducing the Contracting with the Government indicator into the ease of doing business ranking.

Worldwide, public procurement accounts for 10-25% of GDP, and governments spend cumulatively approximately USD 9.5 trillion in public contracts every year. According to most recent data, in OECD member countries procurement accounts for 13.2% of general government expenditures, while developing countries account for over USD 820 billion annually of public procurement spending.

In many sectors, such as transport, infrastructure or education services, public authorities are the principal buyers. For businesses of all sizes in all sectors, the government is a potential customer. And for governments, public procurement is a unique instrument to shape public policy and pursue better allocation of public funds; increased transparency and policymakers' accountability; healthier competition among suppliers; sustainable development; and the fulfillment of international obligations. Inefficient public procurement compromises market access and competition, and raises the price paid by public entities for goods and services, directly impacting public expenditures and therefore taxpayers' resources. Recent studies have shown that inefficiencies in public procurement, including corruption, cause significant welfare losses. In the EU alone, 5 billion are loss each year due to corruption in public procurement (European Parliament, 2016). Average cost overruns can range from 20% to 135% of the initial price of the project in developing economies.

The sheer size of the procurement market for businesses of all sizes – together with the government's unique purchasing power and financial caliber – explains the importance of introducing an indicator benchmarking public procurement in the Doing Business study.

The case study of the indicator focuses on the procurement of road works. This focus was chosen due to the central role the infrastructure sector plays in the development of an economy: worldwide, construction is a USD 1.7 trillion industry. Government investment in the road sector alone accounts for between 2 to 3.5% of GDP. Also, infrastructure projects have a direct impact on a country's economic growth. A strong infrastructure sector promotes trade, connects communities to business centers and creates jobs.

Procurement of road work was also chosen because of its comparability. The procurement contract is for the simple re-pavement of a 2-lane road (a need that most public sectors face quite frequently). The indicator benchmarks efficiency and rules. For efficiency, number of procedures and time to complete them are used as efficiency estimates. Rules measure key aspects of public procurement that are recommended by internationally recognized standards, including e-procurement.

The data collected by the indicator can provide governments with a unique source of reliable and comparable data on public procurement systems, which can inform important reforms to create enabling environments for private sector –led growth and to guarantee a more efficient allocation of public funds.

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Perotti holds a PhD in Econometrics and Empirical Economics from Tor Vergata University in Rome, and her research has focused on firm productivity, skills, labor market regulations, informality, life expectancy and applied microeconometrics.

A Common Sense Approach to Addressing America's Entitlement Challenge

John F. Cogan[1]

The United States faces a fiscal challenge unlike any other in its history. Unless Congress takes action soon to restrain federal pension and health care benefits spending, total central government expenditures will rise to levels unprecedented in peacetime U.S. history. Financing the baby-boom-driven expenditures will require the U.S. Treasury to issue record amounts of federal debt, Congress to impose record high taxes, or some combination of the two.

The challenge faced by the U.S. is not unique among nations of the world. It is one that many developed countries of Europe and Asia confront. The common driving force behind the projected rise in government spending is demography. In each country, the sharp rise in birth rates in the aftermath of World War II followed by significant declines in birth rates will, over the next three decades, result in a substantial increase in senior citizens who are entitled to government pension and health care benefits and relatively small increase in the working age population to finance these benefits.

But demographic change, which is largely beyond the control of central governments, is not the sole cause of the projected rise in unfinanced government spending. The failure of government entitlement policies bears a large portion of the responsibility. In the U.S. the most pronounced of these failures include establishment of wage-indexed defined pension benefits, health care programs with minimal cost-sharing provisions, pay-as-you-go financing of both retiree pension and health care benefits, and an unwillingness to adjust these policies despite foreknowledge of the consequences of slow moving demographic changes.

[1] Senior Fellow, the Hoover Institution, Stanford University. I thank Daniel Heil and Tom Church for their many valuable comments and suggestions and thank Daniel for help in assisting with the calculations for this paper. Most of the calculations presented herein have been made using America Off Balance, an exceptional tool for understanding U.S. federal budget trends modeling the fiscal ramifications of alternative spending and tax policies.

In this paper, I show how modest changes in the design of U.S federal government pension and health care programs for senior citizens, combined with steady sustainable economic growth, can prevent the fiscal burden of senior citizen entitlements from rising appreciably above its current level, despite the projected rise in the size of the beneficiary population. I further argue that modest Social Security changes to limit the growth in the inflation-adjusted value of initial monthly benefits and to raise the retirement age will maintain benefit levels that are fully consistent with the original objectives of the Social Security wage-indexing policy of helping senior citizens avoid a precipitous drop in their standard of living upon retiring and of helping senior citizen standards of living to keep pace with those of the working age population.

This paper has a limited purpose. My intent is not to provide a comprehensive reform plan for Social Security and Medicare. Nor is it an attempt to address Social Security's often vague and conflicting promises. It is merely to demonstrate the cost growth of Social Security and Medicare can be limited without impairing the safety net of assistance they provide.

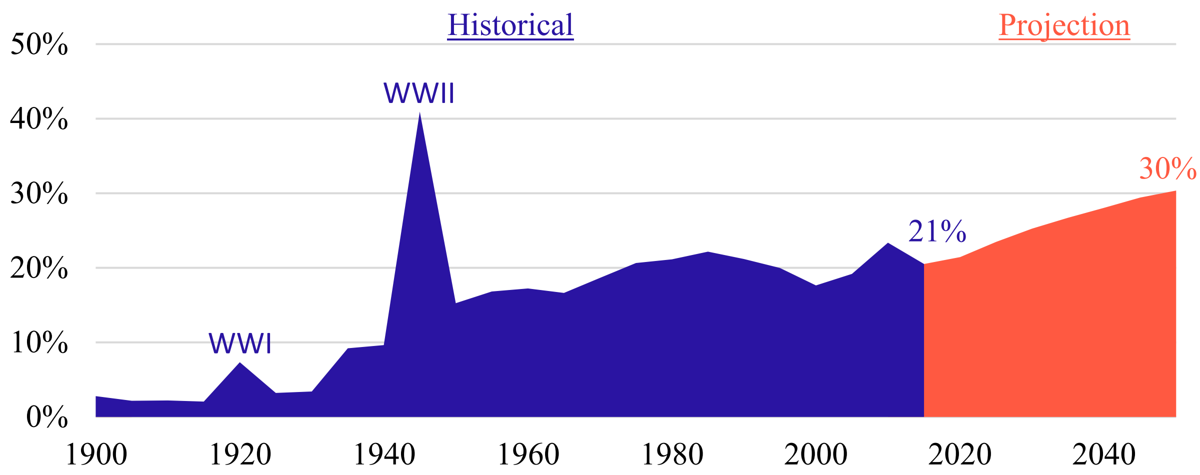
The Dimensions of the Fiscal Challenge

The magnitude of the U.S. fiscal challenge is described with the help of Chart 1. It shows the projected level of federal spending relative to GDP if nothing is done to rein in entitlements and places the projected spending in a long historical perspective. Federal spending is shown as a percent of GDP since the year 1900 and a projection for the next 30 years, which is based on the official Congressional Budget Office projection.[2] The chart shows the fiscal impact of our major wars: in particular, the War of 1812; the Civil War, WWI, and the extraordinary expense of WWII. Also evident in the chart is the New Deal's impact and of the post WWII emergence of the United States as a Great Power. The last spike in federal spending, occurring in 2009 and 2010, is the federal government's spending response to the Great Recession.

The red portion of the chart shows the future path of federal spending unless action is taken to curtail entitlements. Past levels of federal spending, which averaged 19% of GDP during the last half of the 20th century, will pale in comparison to future levels. Federal spending relative to GDP will steadily rise to 27% of GDP in 15 years and to 30% in 30 years.

[2] The projection deviates from CBO by assuming that non-defense discretionary and defense spending levels remain at their current levels relative to GDP in future years. Under the CBO projections, spending levels relative to GDP in both types of programs decline in future years. (CBO 2019)

Chart 1. Total Federal Spending: 1900 to 2048 (% of GDP)



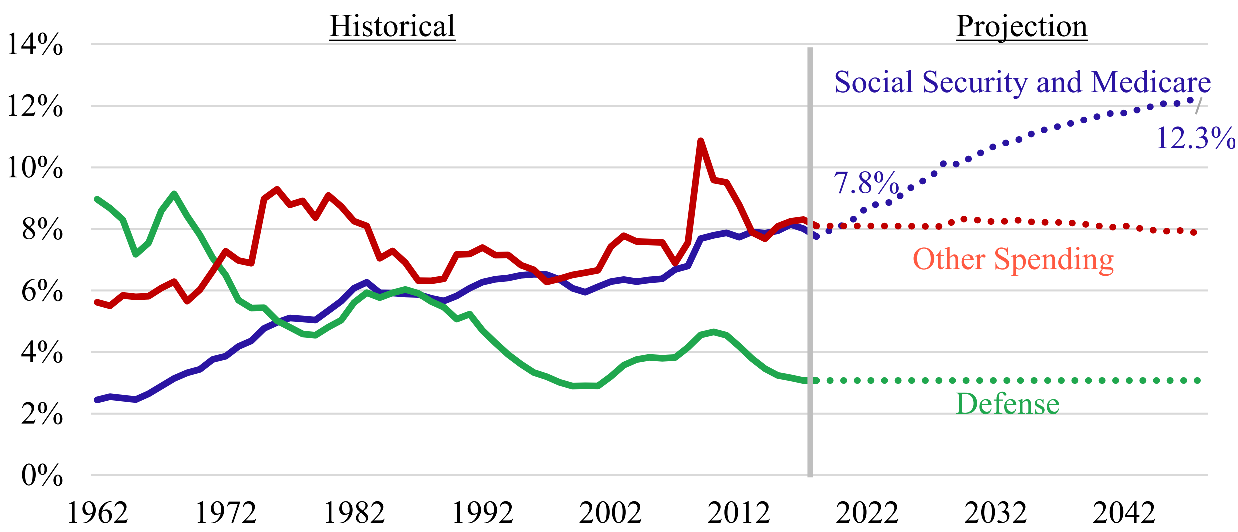
The main driver behind the projected increase in federal government spending is, as is well-known, the two main entitlement programs for the elderly: Social Security and Medicare. Their importance in past and future federal spending trends is shown in Chart 2. The chart decomposes total federal program spending relative to GDP into three categories: Social Security and Medicare (in blue) national defense (in green), and spending on all other federal programs (in red). Interest payments on the outstanding public debt, which are currently just over 2 percent of GDP are not shown. The take away from the historical portion of this chart is that Social Security and Medicare account for all of the growth in federal program spending relative to GDP since at least the early 1960s. The reduction in national defense spending relative to GDP more than offsets the rise in spending on all "other spending" relative to GDP. Thus, taken together, spending on these two components as a percent of GDP has declined. Meanwhile, the steady rise in Social Security and Medicare spending relative to GDP has more than offsets the decline in the rest of federal program spending.

The section of the chart that depicts the future shows the growth in Social Security and Medicare if nothing is done to curtail their growth. Future defense and "other spending" are assumed to remain at their current levels relative to GDP.[3] The takeaway from this chart is that all of the projected future growth in federal program spending as a share of GDP, as all of the

[3] The Social Security and Medicare projections are taken from the CBO long-term budget forecasts. The assumption that the rest of government spending remains a constant share of GDP differs from the CBO projection in which the rest of government spending relative to GDP declines slightly over the next decade before rising back up to its current level.

past growth over the last half century, is due to the projected increase in Social Security and Medicare spending.[4]

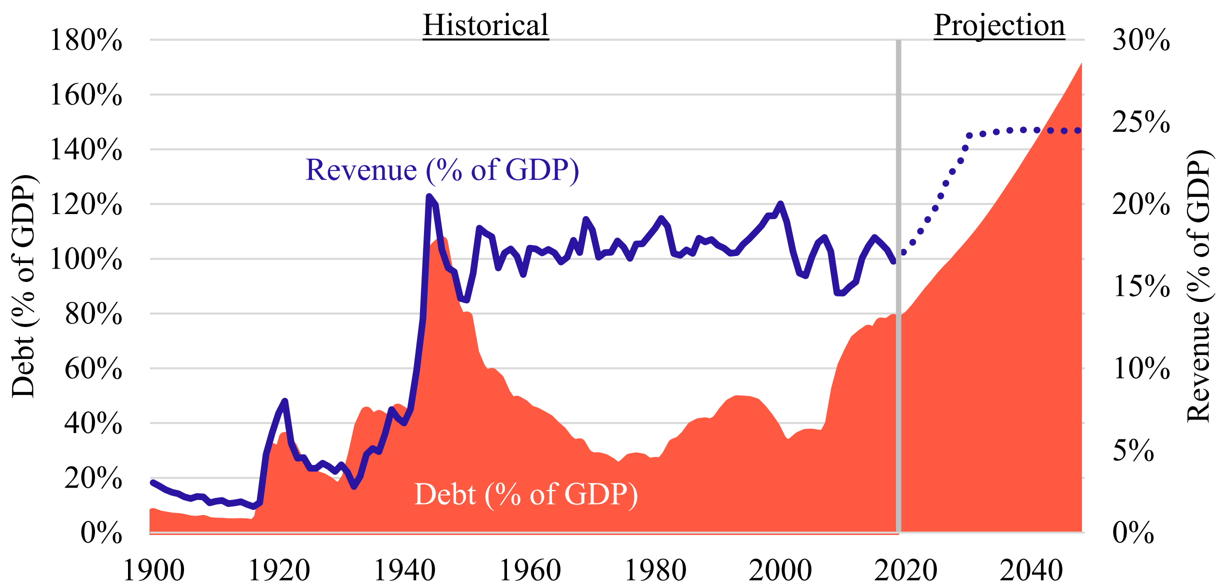
Chart 2. Federal Spending by Category: 1962 to 2048 (% of GDP)



Financing this future spending will require either the imposition of record setting levels of taxes, the issuance of record setting amounts of public debt, the printing of massive amounts of money, or some combination of the three. Chart 3 shows the impact on the outstanding public debt relative to GDP if the government were to rely exclusively on debt to finance the higher spending levels (left-scale, shaded rust colored area) and impact of taxes relative to GDP if it were to rely exclusively on taxation (right scale blue dotted line). Exclusive reliance on debt would cause the debt relative to GDP to rise from its current level of 80 percent to 100 percent in 10 years and would cause it to double to 160 percent in 25 years. Exclusive reliance on higher taxes, on the other hand, would cause the average tax on economic activity to rise from its current level of 17% of GDP to 24% of GDP in 10-years. This would represent a nearly 50% increase in each and every tax rate in the federal tax code. For middle class households, the payroll tax and the marginal federal income tax would each rise from 15% to 22.5%; raising the marginal tax rate to 45% for these households. The top tax rate on capital formation would rise to somewhere in the neighborhood of 70%.

[4] The future spending levels shown in Chart 1 are derived from the data in this chart and include the interest costs associated with financing these expenditures with debt.

Chart 3. Debt and Revenue: 1900 to 2048 (% of GDP)



Economics teaches us that such high tax rates, broadly imposed, reduce economic activity and, thereby, impair standards of living. History teaches us that such high levels of public debt threaten economic prosperity by also reducing economic growth, causing inflation, and making a country's economic system more prone to financial crisis and recession. While the direction of these impacts is clear, the precise amount of economic destruction that would occur is subject to considerable uncertainty.

As disturbing as these ramifications are, readers need to keep in mind Milton Friedman's essential point that the real problem of government finance is higher spending rather than whether it is financed by higher debt or taxes. Every additional dollar of government spending means fewer resources for the private sector to produce, save, or invest. Additionally, every dollar of government entitlement spending carries with it incentives for recipients to work less and save less. And, every dollar government spends on in-kind entitlements is invariably accompanied by government rules and regulations on how funds can be spent. All of these combine to produce lower economic output. The particular means of financing spending, be it issuing debt, raising taxes, or simply printing money may each have different adverse economic consequences. But, the ultimate source of any resulting economic woe is spending. Thus, the challenge the U.S. faces is how to reduce the rising government burden and not, as most elected officials in Washington believe, how to finance it.

How to think about meeting the fiscal challenge?

In the usual treatment of rising senior citizen entitlement spending, focus is placed almost exclusively on demographics. According to the U.S. Bureau of the Census, there are currently 56 million persons age 65 and older. In 20 years, there will be 81 million; an increase of 25 million in just two decades.[5] Over the same period of time, the number of employed persons is expected to increase by fewer than 10 million.[6] As senior citizens come forth to claim their Social Security and Medicare benefits, federal expenditures will rise rapidly. The relatively slow growth in the number of workers means relatively fewer workers to finance these claims.

In this view, there is little that can be done to reduce the rising gap between senior citizen entitlements and revenues except to either significantly raise payroll and other taxes, or sharply reduce entitlement benefits.

But demographics are only part of the reason why senior citizen entitlements are projected to increase. Another reason is that Social Security and Medicare promise benefits to future recipients that are far higher than those received by today's senior citizens. Monthly benefits promised to future Social Security recipients are higher even after adjusting for the rise in consumer prices and future government Medicare expenditures per enrollee are higher even after adjusting for the rise in medical care prices.

Chart 4 provides examples of the amount by which Social Security benefits promised to future retirees exceed those of today's retirees, after adjusting for inflation. The orange bar shows the amount the typical person who reaches age 65 this year will receive on an annual basis: $20,766. The blue bars show the amounts Social Security promises to typical persons (in 2019 dollars) at age 65 who are currently age 50 and 40, respectively. The increase in promised benefits in inflation-adjusted dollars is not trivial. Social Security promises the typical worker who is 50 years-old today benefits that have 14 percent more purchasing power than today's

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[5] https://www.census.gov/data/tables/2017/demo/popproj/2017-summary-tables.html, Table 2

[6] To obtain this estimate, the Census projection of the increase in the number of persons age 18-64 was multiplied by the current employment to population ratio of 63 percent. https://www.census.gov/data/tables/2017/demo/popproj/2017-summary-tables.html, Table 2

benefits. The typical worker who is 40 years-old today is promised benefits that have 29 percent more purchasing power.

Chart 4. Social Security Average Initial Benefits (2019 $)

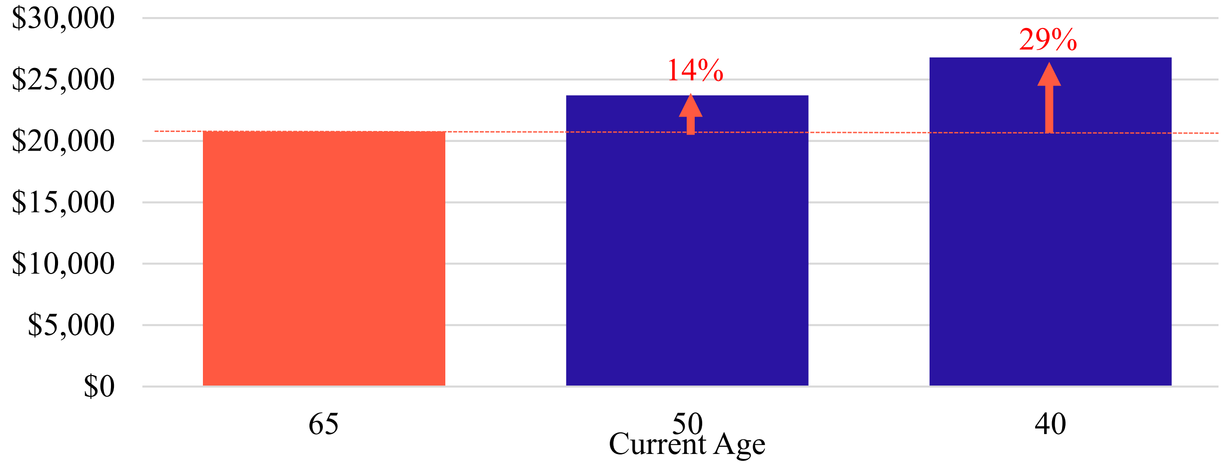
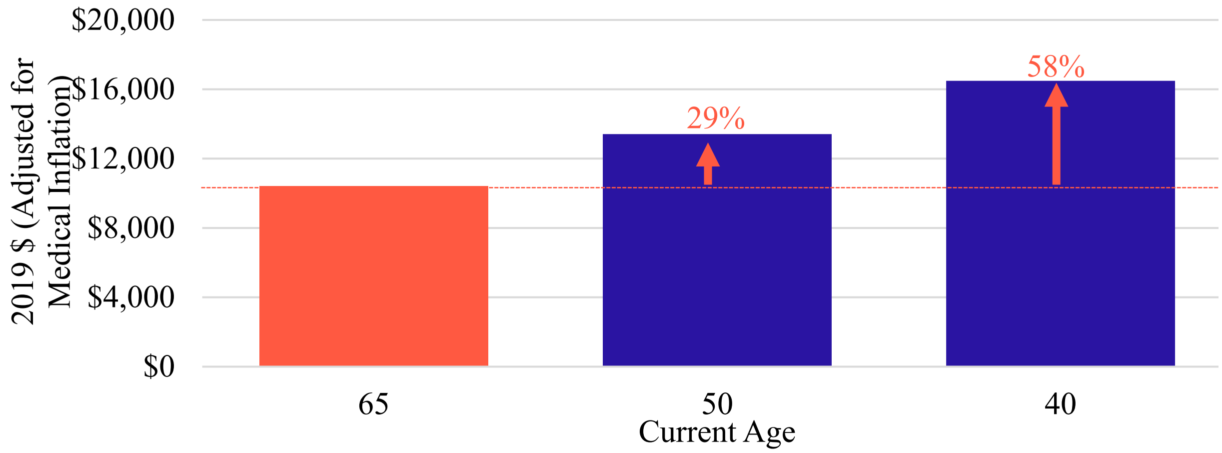


Chart 5 shows the increases in government Medicare expenditures adjusted for medical price inflation.[7] In 2020, the government will spend an average of $10,826 on Medicare enrollees. In 15 years, the government is projected to spend 29 percent more on each Medicare enrollee, *after adjusting for the projected nearly 60 percent rise in economy-wide medical care prices*. In 25 years, it is projected to spend 58% more.

Chart 5. Medicare Spending per Recipient (2019 $)



[7] The MCPI is assumed to increase at an annual rate of 3.1 percent; about 50 percent faster than the 2.2 percent annual growth rate of the CPI assumed by CBO.

These extraordinary increases in inflation-adjusted Social Security benefits and Medicare expenditures per enrollee are the result of specific policies imbedded in each program. In Social Security, the inflation-adjusted benefit increases are purposely designed to achieve specific policy goals. The increases in Medicare expenditures per enrollee are largely the unintended consequence of a poorly designed program.

Social Security Benefit Increases

The current policy for determining Social Security benefits dates back to the 1970s. Since that time, monthly benefits have been automatically determined without the need for Congress to act. Since that time, benefits for persons who have already begun receiving Social Security have been indexed to the annual rate of consumer price inflation. This cost-of-living adjustment is designed to compensate recipients for the loss of purchasing power caused by rising prices. Less well-understood is the policy for setting *initial benefits* for persons who are receiving Social Security for the first time. The policy for determining these initial benefits is crucial to understanding the growth in Social Security over time. Hence, it will be useful to take a few minutes to describe the policy and the goals it seeks to achieve.

Stripped down to its barest essentials, the initial benefits policy automatically indexes the growth in initial benefits over time from one group of new retirees to the next to the growth in the economy-wide average wage. Thus, the average initial benefits received by newly retired workers in any one year will exceed the average initial benefits received by newly retired workers in the preceding year by the increase average wages during that year. Another way to explain the outcome using a longer period of time is to say that if, over a 10-year period, the average level of wages in the economy grows by 10 percent, then the initial Social Security benefits received by the typical new retiree in the 10th year will be 10 percent higher than the benefits received by the typical new retiree in the 1st year.

This policy, which was established in 1977, is designed to achieve two primary objectives. The first objective is to ensure that the standard of living of newly retired persons keeps pace with improvements in the standard of living of the rest of the population. By ensuring that initial

Social Security benefits for new retirees grow over time at the same rate as average wages in the economy, Social Security's wage-indexing policy roughly achieves this objective.[8]

The second objective of the wage-indexing policy is to prevent new retirees from experiencing a precipitous drop in their income, i.e., their standard of living, upon retirement. The drop could be prevented by replacing a certain percentage of workers' pre-retirement income with a sufficient level of initial Social Security benefits and maintaining this *replacement rate* over time as one group of new retirees followed another. The policy of indexing initial Social Security benefits to economy-wide wages precisely achieves this outcome if the relationship between the average economy-wide wage and the wages of workers as they near retirement remains the same over time. Under this condition, both wages rise at about the same rate over time. Since initial Social Security benefits were indexed to economy-wide wages, the initial benefits received by new retirees also rise at this same rate. With initial Social Security benefits and workers' pre-retirement wages rising at the same rate, initial benefits remain a constant percentage of workers' pre-retirement wages over time.

Increases in Medicare Expenditures per Enrollee

The rapid growth in Medicare expenditures per enrollee are due largely to flaws in Medicare's structure that encourage the overutilization of medical services and the use of more complex and costly medical procedures. The two principal flaws are low copayments charged to enrollees for Medicare services and fee-for-service reimbursement policies for physicians and other health care providers for services delivered outside the inpatient hospital setting. Low copayments insulate Medicare patients from the true cost of medical services and, thereby, create incentives for patients to over-utilize these services. Fee-for-service reimbursement creates incentives for physicians and other health care providers to provide more services and more complex services so long as the marginal cost of providing these services exceeds their respective reimbursement rates. Taken together, the "moral hazard" induced by these incentives is a recipe for rapidly rising Medicare utilization rates, greater use of more complex and more-costly medical services, and consequently, rising government Medicare expenditures per enrollee.

[8] See Cogan (2017) and Commission on the Social Security "Notch" Issue (1994) for a discussion of the 1977 law.

Some Policy Considerations

The straightforward implication of the forgoing discussion is that polices to limit the growth in inflation-adjusted Social Security benefits and Medicare expenditures per enrollee can play a role, possibly an important one, in meeting the U.S. fiscal challenge. But before turning to the question of the magnitude of their role, a discussion of importance of economic growth is in order.

A growing economy is crucial to meeting the challenge. Economic growth creates less of a need for assistance to senior citizens and more resources to finance the remaining need. With economic growth comes higher earnings and greater investment returns, both of which increase the ability of individuals to provide for their own retirement needs. With economic growth comes additional government revenues to finance needed assistance with less reliance on higher taxes.

How much does economic growth matter? The answer is that higher growth alone cannot provide all of the additional resources to meet the fiscal challenge. But it can help make the challenge more manageable. The Congressional Budget Office economic projections, upon which the preceding charts are based, assume that real GDP will grow annually at the rather anemic rate of only 1.9 percent per year over the next three decades. This rate is below the average annual 2.2 percent GDP growth rate that has occurred over the last 20 years and during the last 8 years beginning a year after the Great Recession ended. If the economy were to sustain this 2.2 percent annual growth, the fiscal burden of federal government spending, measured by total federal spending relative to GDP would decline from its current projected rise by about one-quarter to one-third.[9] The remaining fiscal challenge still remains a formidable one. The bottom line is that, by itself, economic growth is not sufficient. Social Security and Medicare expenditure growth must be curtailed through policy change. For the calculations in the

[9] How reasonable is 2.2% real GDP growth? As John Taylor, Glenn Hubbard, Kevin Warsh and I have argued (Cogan et al 2017), with the right set of economic policies, 2.2% real growth is very achievable. It requires only that worker productivity grow at an average 1.8% per year. Over the last 30 years, it has grown at 2 percent per year. In all 30-year periods dating back to the period ending in 1978, only once has productivity averaged less than 1.8 percent, and that was only by a smidgeon. Increases in the employment-to-population ratio increases in addition to the 1.8 percent productivity growth would produce an even larger increase in GDP growth.

remainder of this paper, we have replaced the CBO 1.9 percent annual real GDP growth rate with a 2.2 percent annual rate.

<u>Purchasing Power Constant Benefits</u>

The fact that both inflation-adjusted Social Security benefits and medical inflation-adjusted Medicare expenditures per enrollee are rising over time leads naturally to the question of how much of the fiscal challenge can be met by limiting future increases in the per recipient expenditure in each program to their respective inflation rates: the CPI for Social Security and the MCPI for Medicare. Such a policy would, in the aggregate, allow program recipients in the future to purchase the same level of goods and services and medical care as current retirees. The policy would not involve any reduction in the aggregate purchasing power of expenditures in either program and hence can be thought of as a "purchasing power constant" policy.

Chart 6 shows the projected growth in combined Social Security and Medicare expenditures relative to GDP holding the inflation-adjusted value of the benefits of both programs constant at their current levels. The chart compares that growth to the growth projected under current law (the latter is reproduced from chart 2). As the chart shows, the purchasing power constant policy virtually eliminates all of the projected increase in the future fiscal burden of Social Security and Medicare. Their combined expenditures relative to GDP gradually rise only slightly over the next decade (from 8.0 percent to 8.4 percent in 2028) and then gradually decline to below their current level in just over two decades.

Chart 6. Spending on Social Security and Medicare (% of GDP)

The intuition behind what is perhaps a surprising result can be had by focusing on Social Security. Under the constant purchasing power policy, aggregate Social Security benefits grow at the rate of inflation plus the rate of growth in the number of recipients. GDP grows at the rate of inflation plus the rate of growth in real GDP. Whether Social Security benefits rise or fall relative to GDP depends upon whether the growth in the number of Social Security recipients is higher or lower than the growth in real GDP. Over the next 10 years, the number of Social Security recipients is projected to grow at an average annual rate of 2.1%; a notch below the assumed real GDP growth rate. Thus, 8 years from now Social Security expenditures relative to GDP is roughly equal to its level today. Thereafter, the number of Social Security recipients grows at a rate less than the real GDP growth rate and, under the purchasing power constant policy, Social Security expenditures would decline relative to GDP. A similar intuition applies to Medicare if spending per enrollee were capped at consumer prices rather than medical inflation.

In the data underlying chart 6, Medicare expenditures per enrollee grow at the rate of growth in the MCPI which is about 1 percentage point per year faster than the annual growth in consumer prices. This more rapid growth and the fact that for the next decade the number of program participants rises faster than real GDP accounts for the slight rise in combined Social Security and Medicare relative to GDP during the next decade. In the following decade and beyond, the number of program recipients is projected to grow less rapidly than the 2.2 percent real GDP growth rate and the fiscal burden of Social Security and Medicare begins to fall.

The key takeaway from this analysis, one that warrants special emphasis, is that the fiscal challenge presented by Social Security and Medicare can be met without reducing the aggregate purchasing power of benefits provided by either program. Retirees in the future can enjoy the same level of Social Security and Medicare benefits as current retirees. Deep reductions in benefits that allegedly shred the senior citizen safety net are not necessary.

The Impact of Specific Social Security and Medicare Policy Changes

This section shows how specific modest changes to restrain Social Security and Medicare spending can prevent expenditures on these programs from rising appreciably relative to GDP. It is important to keep in mind that the purpose of this exercise is a narrow one. The policies I describe should not be construed in any way as comprehensive reform package. They do not constitute a fundamental restructuring Social Security and Medicare, nor do they address important distributional issues. Their purpose is merely to show that the fiscal challenge can be effectively met without deep cuts in program benefits.

For Social Security, I consider two policies. The first is to limit the growth in initial benefits promised to future new retirees to the growth in the consumer price level rather than average wages. Under this policy, the initial monthly benefit the typical new retiree receives at Social Security's normal retirement age in any given year would be higher than the initial benefit received by the typical new retiree in the previous year by the rate of inflation. For future recipients who retire at Social Security's normal retirement age, this policy would preserve the purchasing power of their initial benefits at today's level.

The second Social Security policy is to gradually increase Social Security's retirement age. Under current law, starting this year, Social Security's normal retirement age starts to rise by two months each year until it reaches age 67 in 2026. The proposed policy is to continue this rate of increase beyond 2027 until Social Security's retirement age reaches 70. The increase is roughly in-line with the projected increase in life expectancy over the next 30 years.[10]

Holding the growth in Medicare expenditures per enrollee to the growth in medical prices may seem like a tall order. But the experience of Medicare spending over the past several decades provides some confidence that it can be achieved, if policymakers avoid expansions of

[10] CBO estimates that life expectancy at birth will increase by 3.3 years over the next 30 years (CBO 2019).

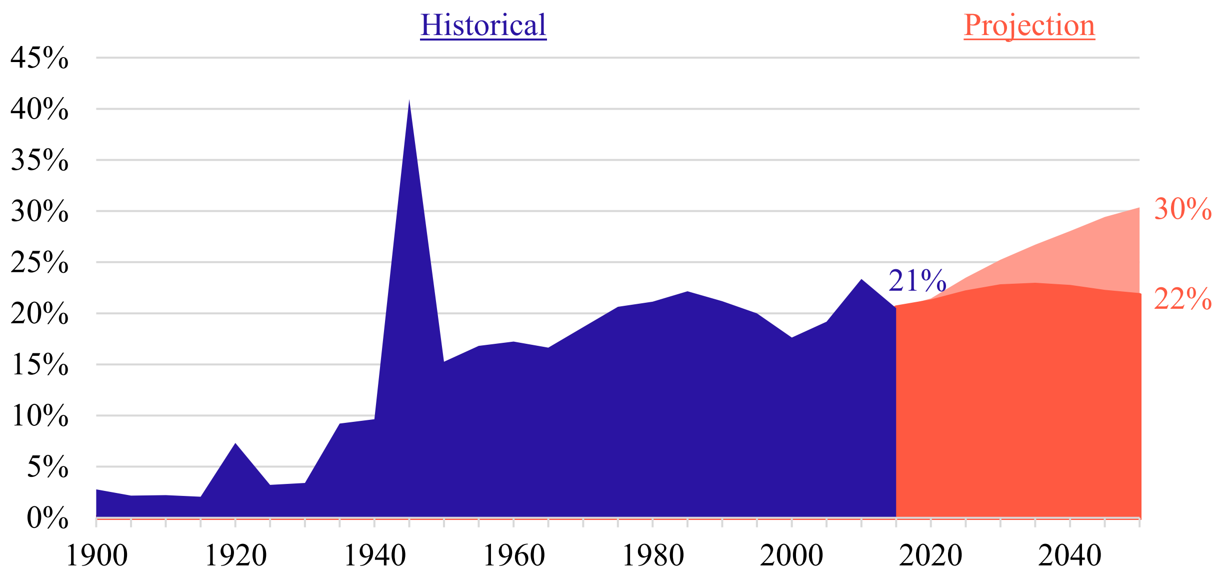
the program. During the last twenty years, there has been only one significant Medicare expansion; namely the addition of prescription drug coverage in 2003 (Part D). Excluding Part D expenditures, Medicare spending per enrollee has risen more slowly than the MCPI during the last 10 years (1.9% vs 3.0%) and at the same rate as the MCPI over the last 20 years (3.5%).

Additional policies are likely to be needed to keep the future growth in Medicare expenditures per enrollee at a rate no higher than the MCPI. The increasing age of the senior citizen population over the next 30 years will create upward pressure on medical expenses per enrollee. This upward pressure can be offset by policies that make seniors more cost-conscious. An obvious policy to do this is to gradually increase the Part B coinsurance rate that applies to physician and other non-inpatient hospital services from its current 20 percent to 30 percent.

The history of Medicare demonstrates the political difficulty of raising copayments. Most attempts have failed. But as we noted during the discussion of Medicare's design flaws, the program's low copayments contribute to the over utilization of medical services. Correcting this flaw is one of the essential policy changes that should accompany any Medicare reform package.

Chart 7 shows the impact of these policies on total government spending, including interest on the outstanding public debt. The light orange color shows the projected level of federal government spending relative to GDP in the absence of any policy changes. This portion of the chart reproduces the spending trajectory reported in Chart 1. The dark orange color shows the projected level federal government under the Social Security policies described above. Federal spending rises gradually from its current level of 21 percent of GDP to 22.7 percent over the next 15 years. Thereafter, it steadily declines to a level of 21.5 percent in 30 years. The three modest policies prevent the large rise in future federal spending from the rapidly increasing size of the senior citizen population. Along with a modest 2.2 percent annual economic growth rate, they largely meet the federal government's fiscal challenge.

Chart 7. Total Federal Spending: 1900 to 2048 (% of GDP)



Senior Citizens Income

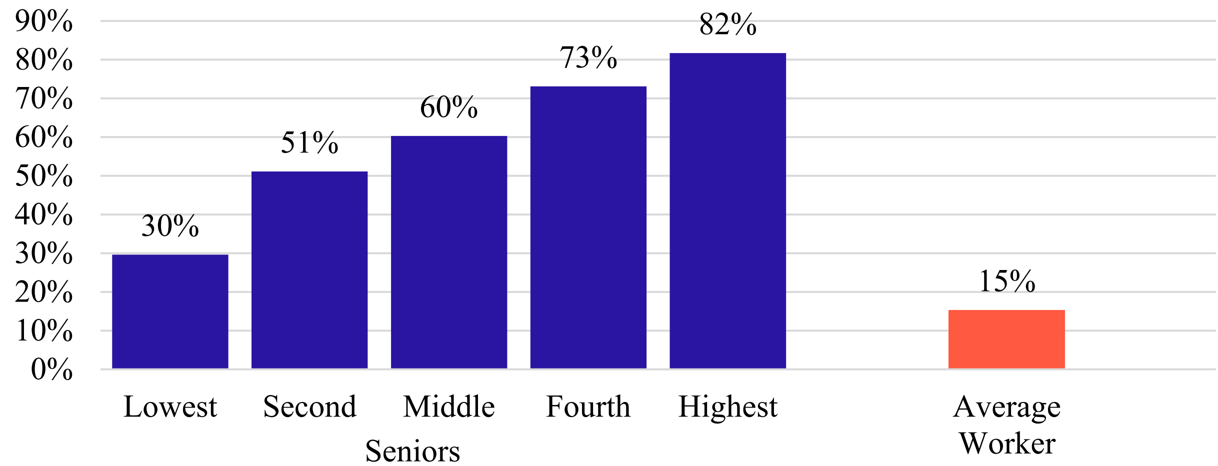
Any consideration of Social Security and Medicare policy change must consider how the income of households headed by persons age 65 and older have fared under existing policies. Social Security's wage-indexing policy has been in place since the early 1980s.[11] So in evaluating any policy change that moves away from wage-indexing, it is natural to evaluate changes in income levels of senior households since that time and against the two goals that wage-indexing policy has sought to achieve.

One goal is to ensure that improvements in living standards of senior citizens keep pace with the growth in living standards enjoyed by the working age population. Chart 8 sheds some light on the extent to which this goal has been achieved. The blue bars show the growth since 1980 in the inflation-adjusted median income of households headed by persons age 65 or older (termed senior households) for each quintile of the senior household income distribution. Focusing first on the overall income growth for senior households, the overall median is given by

[11] The wage-indexing policy became effective for persons born on or after January 1, 1917. The policy had a 5-year phase-in period during which retirees received a benefit level which was a blend of the old formula and the new formula. Thus, the current wage-indexing policy partially affected the initial benefits of persons who retired at Social Security's normal retirement in 1982 and fully affected the initial benefits of persons who retired at the normal retirement age in 1987. (for details see, Commission on Social Security "Notch" Issue, 2014.)

the growth for the middle quintile, which is 60 percent. The orange bar shows the growth in the median income of households headed by persons under age 65 (termed non-senior households). Median senior household income has grown four times faster than median non-senior income. The more rapid growth in senior household income has raised the median senior household income relative to non-seniors significantly, from 43 percent in 1980 to 59 percent in 2017.

Chart 8. Real Household Income Growth from 1980 to 2018



Increases in earnings from work and in retirement income mainly from private pension plans account for the lion's share of the increase in senior household income. The rising inflation-adjusted value of Social Security benefits due to wage-indexing has played only a relatively minor role in the relative growth of senior household income. Inflation-adjusted median household Social Security benefits increased by 40 percent since 1980. Had the median benefit remained at its 1980 level, median senior household income would have increased by 38 percent instead of 60 percent. This growth is still more than twice the growth in non-senior household income.

Turning now to a comparison of senior household incomes by quintile, the growth in the median senior household income of each quintile of the distribution of senior income is much higher than the 15% growth in the median income of all non-senior households. The median income of poorest fifth of senior households grew nearly twice as fast; the median income of the second poorest by more than three times as fast; the middle by nearly four times as fast, the second richest by nearly five times as fast and the richest fifth of senior households by nearly six times as fast.[12]

The data show that the growth in senior household income over the last four decades has been accompanied by a sharp increase in the dispersion of income.[13] Since at least 1980, the growth rates rise monotonically from the lowest to the highest quintile. The fastest income growth has consistently occurred among higher income seniors and the slowest growth among the lowest income seniors. As a result, the median income of the top income quintile of seniors relative that of the middle quintile is now 23% higher than it was in 1980. The median income of the middle quintile relative that of the lowest quintile is now 21% higher. This increase in the degree of income inequality among senior households has, as we will argue later, important policy implications for Social Security reform.

The main takeaway from this chart is that in the years since wage-indexing was established, incomes of senior households who are largely the group collecting Social Security, has not just kept pace with that of non-senior households, who are largely the group paying taxes to finance these benefits, it has a grown about four times faster. The more rapid income growth among senior households compared to the income of the typical working household has been an across-the-board phenomenon.

The second goal of Social Security's wage-indexing policy was to prevent household incomes from dropping precipitously when the household's main breadwinner reaches retirement age. A major contribution to our understanding of how well Social Security helps achieves this goal was recently made by Bee and Mitchel (2017). Combining information on demographic characteristics of household with income data obtained from IRS records and Social Security earnings and benefits obtained from Social Security Administration records, Bee and Mitchel were able to construct the path of household income of individuals in the years immediately preceding and after their retirement. More specifically, Bee and Mitchell were able to identify the age at which individuals began collecting Social Security benefits. They then used the tax

[12] When means are used instead of medians the story is much the same with two notable exceptions. First, the mean income growth among the poorest fifth of senior households is slightly below that of the median among non-senior households (30% for seniors vs 35% for non-seniors). Second, the relative growth of mean incomes of each quintile is less than in the corresponding growth measured using median incomes.
[13] see Poterba (2014)

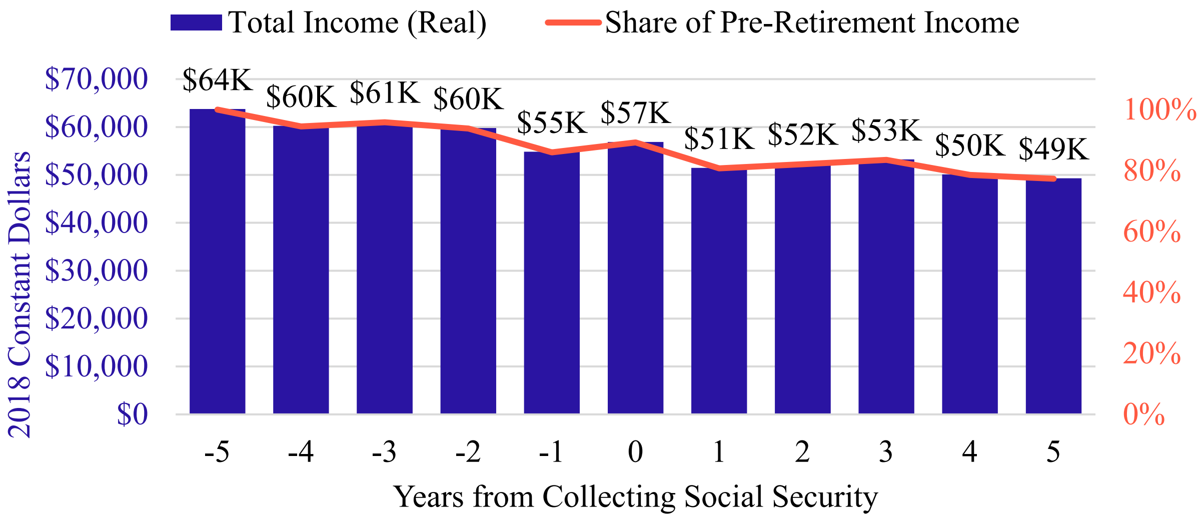
returns of these individuals to obtain their IRS reported income in the year in which the individuals began collecting Social Security benefits and in each of the five years preceding and succeeding that year

Chart 9 reproduces Bee and Mitchell's results for persons with the median household income. The left-side axis and the bars show median household income levels for each of the five years before and after the first year the household head collects Social Security retirement benefits. The year in which the household head begins collecting Social Security is designated "0." The right-side axis and the red line express each year's income as a percentage of the household's income five-years before the household head begins collecting Social Security.

As the data show, there is only a modest decline in median household income in the years after workers begin collecting Social Security benefits relative to those in the years leading up to first collecting Social Security benefits. The income decline from 5 years prior to first receiving Social Security to the first year benefits are received is a modest 11 percent. The income decline from 5 years before first collecting Social Security to five years after is only 23 percent; about two percent per year. It is important to keep in mind that these modest reductions likely overstate the reductions in disposable income since tax rates on Social Security benefits and capital income which is typical drawn upon during retirement years are lower than on wage earnings which are the primary source of pre-retirement income.[14]

[14] The results for workers who are at the 25th and 75th percentile of the income distribution of persons initially collecting Social Security benefits are similar. The decline in income for both groups is modest. The decline is slightly lower for persons at the 25th percentile than for persons at the median and is slightly higher for those at the 75th percentile.

Chart 9. Total Income Before and After Retirement



Bee and Mitchell do not provide sufficient data to enable us to calculate the importance of wage-indexed benefits in preventing household income from sharply declining as heads of households reach retirement age. But an upper bound estimate can be made. From the Health and Retirement Survey, we know that about 25 percent of the median household's income in the year the household reaches retirement age consists of Social Security benefits. For the median household, Social Security benefits would be about $3,000 lower had initial benefits been indexed to consumer prices rather than to wages. This amounts to 5 percent of median household income in the year in which Social Security benefits were first received. Hence, median household income from 5 years before the household first received Social Security to the year it first received benefits would have been 16 percent instead of the 11 percent reduction shown in Chart 9.

<u>Concluding thoughts</u>

The fiscal challenge presented by rising government expenditures is one that is common among most developed countries. This paper has emphasized that demographic change is only part of the reason for the future increases in the government spending burden. At the federal level in the United States, Social Security and Medicare policies play an important role by increasing inflation-adjusted value of government payments per enrollee.

This paper has shown that if the purchasing power of future government payments to each Social Security and Medicare recipient can be held at its current level, the high cost of rising future expenditures can largely be avoided. Although fundamental reform is desirable, modest policy changes alone can achieve this result. We have shown that price indexing Social Security benefits, continuing the gradual increase in Social Security's retirement age, and increasing Medicare coinsurance rates can achieve this outcome.

The aforementioned policies are illustrative of the type of modest policies that will meet the U.S. federal fiscal challenge. Other Social Security and Medicare policies, in particular those which account for the distributional consequences of rising income inequality in senior citizen incomes, are the subject of future research.

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Key Milestones in Regulation

- Susan E. Dudley

In the 130 years since Congress created the first regulatory agency, the number of agencies and the scope and reach of the regulations they issue have increased dramatically. In 2019, more 70 federal regulatory agencies employed almost 300,000 people to write and implement regulation. Every year, they issue thousands of new regulations, which now occupy more than 180,000 pages of regulatory code. This essay summarizes efforts to constrain that growth, identifying five key milestones that have shaped regulatory practices in the United States from the middle of the last century to today. It is based on an article published in the Penn Regulatory Review.

Milestone 1: The Administrative Procedure Act

Congress created the Interstate Commerce Commission (ICC) in 1887 to regulate railroad rates. In the following decades a variety of agencies were established to regulate interstate trade, water and power, communications, commodity exchanges, etc. In the 1930s, President Franklin D. Roosevelt's New Deal expanded the jurisdiction of these agencies and added new ones, but their sweeping authorities began to raise concerns that the apparent delegation of Congress's Article I powers might be unconstitutional. Years of debate on this question led to the passage in 1946 of what was arguably the first regulatory reform bill—the Administrative Procedure Act (APA). The APA reflected a "fierce compromise," balancing the competing goals of bureaucratic expertise and legislative accountability. Its requirements—that regulations be grounded in statutory law and an administrative record that includes public notice-and-comment—continue to guide rulemaking today.

Milestone 2: Economic Deregulation

The 1970s and 1980s brought a wave of deregulation. The "economic regulation" prevalent at that time relied on economic controls such as price ceilings or floors, quantity restrictions, and service parameters. Although one justification for agencies such as the ICC, the Civil Aeronautics Board (CAB), and the Federal Communications Commission was protection of consumers from the exercise of producers' market power, observers noted that they seemed to get "captured" by the industries they regulated. By the early 1970s, legal and economic scholarship generally recognized that economic regulation of prices, entry, and exit tended to keep prices higher than necessary, benefiting regulated industries at the expense of consumers. This awareness motivated bipartisan deregulatory efforts across all three branches of government that eventually led to the abolition of some agencies, including the ICC and CAB, and removal of unnecessary regulation in several industries. The deregulation of transportation and telecommunications that occurred in the 1970s and 1980s succeeded in increasing competition, which lowered consumer prices and increased choices, and provided tens of billions of dollars per year in consumer benefits.

Milestone 3: Benefit-Cost Analysis

While economic forms of regulation were declining in the 1970s, a new type of "social regulation" began to emerge, aimed at protecting health, safety, and the environment. Concerns over the reporting and compliance burdens these rules created led to the next wave of regulatory reform, focused not on deregulation but on ensuring that regulatory benefits outweighed costs. In 1978, President Carter issued Executive Order (E.O.) 12044, which established procedures for analyzing the impact of new regulations and minimizing their burdens. In 1980, Congress passed and Carter signed the Paperwork Reduction Act, which created the Office of Information and Regulatory Affairs (OIRA) in the Office of Management and Budget to review and approve all new reporting requirements. Benefit-cost balancing has since become standard practice in most regulatory agencies, and increasingly is expected by reviewing courts.

Milestone 4: White House Review

Soon after he took office in 1981, President Reagan issued E.O. 12291, giving the newly created OIRA a gatekeeper role in reviewing draft regulations (as well as paperwork) to ensure that their benefits exceeded their costs. While this order was initially controversial, each subsequent president has continued and expanded OIRA's central regulatory oversight role, as well as the economic principles embodied in Reagan and Carter's orders.

In 1993, President Clinton replaced E.O. 12291 with E.O. 12866, which remains in effect today, despite the very different regulatory rhetoric of Presidents Bush, Obama, and Trump. E.O. 12866 retained OIRA's review of significant new regulations; it reinforced the philosophy that regulations should be based on an analysis of the benefits and costs of all available alternatives, and directed agencies to select regulatory approaches that maximize net benefits to society unless otherwise constrained by law.

Milestone 5? Regulatory Budgeting

Are we witnessing the next wave of regulatory reform? President Trump has made deregulation a high priority. Although he retained E.O. 12866, he overlaid its requirements to maximize net regulatory benefits with an incremental regulatory budget. His E.O. 13771 requires agencies to remove two regulations for every new one issued, and to offset the costs of new regulations by removing or modifying existing rules. This emphasis on reducing regulatory costs reflects a dramatic departure from the focus on net benefits that has prevailed for social regulations.

To date, E.O. 13771 has led to a sharp reduction in the issuance of new regulations, as well as to the modification and removal of some existing regulations. Nevertheless, Trump's initiatives have not come close to achieving his promise of cutting regulations by 75%, and that is due to the regulatory process that previous reforms have instituted. To remove or revise an existing regulation, agencies must follow the notice-and-comment procedures of the APA to build a regulatory record they can defend in court. They must also demonstrate that the benefits of proposed deregulatory actions outweigh the costs.

Whether Trump's policies become a permanent fixture of the U.S. regulatory landscape remains to be seen. The next president could rescind his executive orders with the stroke of a pen. Like earlier milestones in regulatory reform, the nascent regulatory budget has been initially controversial, and it is too soon to tell whether it will achieve comparable durability. Looking back, however, it is striking to see the degree of bipartisan consensus on the need to develop practical tools for managing the administrative state. As President Carter's Economic Report of the President concluded in 1980:

> The Nation must recognize that regulation to meet social goals competes for scarce resources with other national objectives. Priorities must be set to make certain that the first problems addressed are those in which regulations are likely to bring the greatest social benefits. Admittedly, this is an ideal that can never be perfectly realized, but tools like the regulatory budget may have to be developed if it is to be approached.

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The Quest for Fiscal Rules

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The Quest for Fiscal Rules

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Abstract

James Buchanan pioneered the political economics of public debt 60 years ago. In this paper, we contrast his thinking of the burden of debt, the public choice mechanisms that lead to excessive debt and the demand for constitutional restraints on public debt with its development, its sustainability, the evidence on the political economy of debt and on the effects of institutions. It turns out that Buchanan farsightedly anticipated the problems that would emerge from excessive indebtedness in the developed world. The introduction of fiscal rules appear as a late triumph of Buchanan's thinking. However, socialism is dead, but Leviathan lives on. Opposition to sound fiscal policies has increasingly dominated the public debates since the Great Recession.

JEL-Classification: H6, E6, D72, K39

Keywords: James Buchanan, Public Debt, Fiscal Commons Problems, Fiscal Rules

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There will be no escape from the protectionist-mercantilist regime that now threatens to be characteristic of the post-socialist politics in both Western and Eastern countries so long as we allow the ordinary or natural outcomes of majoritarian democratic processes to operate without adequate constitutional constraints.
James M. Buchanan (1990)

1. Introduction

Jim Buchanan was concerned with problems of public debt throughout his academic career. Starting with his first monograph *Public Principles of Public Debt* (Buchanan 1958) via *Democracy in Deficit* (1977), his book with Dick Wagner, to papers in the 1990s (e.g., Buchanan 1997), he analyzed the incidence of public debt, the Keynesian shift in fiscal policy, their meaning for political decision-making processes and the necessity for constitutional restraints on public debt. Indeed, his insights on public debt incidence, the question that, according to Brennan in his foreword to Volume 2 of *The Collected Works*, came to him as a flash of inspiration, only provided for a starting point of subsequent analyses. If public debt constitutes a burden to future taxpayers, it might induce decision-makers in current politics to incur excessive indebtedness and reveal a deficit bias in fiscal policies. Such deficit bias should be restrained by constitutional rules in order to avert harm from future generations. Buchanan's theory of public debt thus provided the foundation for an extensive and still growing public choice literature on the political economics of public debt.

His thinking on public debt is embedded in his theory of fiscal exchange (Buchanan 1949, 1967). Buchanan's basic concern was that the democratically constituted Wicksellian link between public spending and revenue raising could be fundamentally harmed if today's taxpayers vote for themselves expenditures on the expense of future generations. Access to public debt thus necessarily has an impact on the conduct of democratic politics. And Buchanan feared that this impact will not be a beneficial one.

In this paper, I will analyze to what extent Buchanan clearly and farsightedly anticipated the problems emerging from excessive indebtedness by starting in Section 2 with a brief look at the development of public debt across time and space. This is followed by remarks on different aspects of the sustainability of public debt in Section 3. In Section 4, I discuss the reasons for public debt in the sense of a positive analysis, in particular focusing on the extensions of Buchanan's thinking about excessive debt that finally lead to the quest for fiscal rules. In Section 5, the effects of such institutional restraints on public debt are summarized. Concluding remarks follow in Section 6.

2. Public Debt in Time and Space

Buchanan's reasoning about public debt, at first glance, implies the existence of a deficit bias in fiscal policies leading to increasing debt across time. Figures 1 and 2 exhibit the development of debt to GDP ratios from the 1970s to 2017. In Figure 1 (left panel), the four member countries of the G7 which are not member states of the European Monetary Union (EMU) are displayed, while Figure 1 (right panel) shows debt to GDP ratios of the four large EMU countries, i.e., the remaining G7 countries plus Spain. I have taken the debt to GDP ratio because it plays a role in the discussion about debt sustainability. Real debt would even show a more dramatic time pattern.

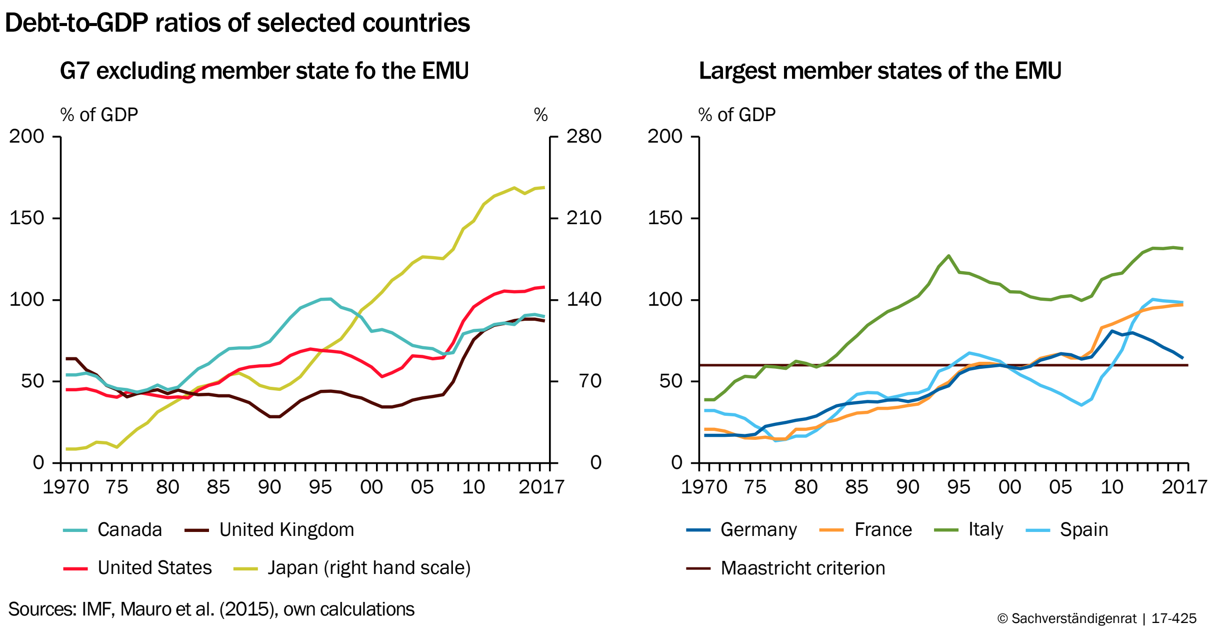


Figure 1: Debt to GDP Ratios of Large OECD Countries, 1970 – 2017

Source: German Council of Economic Experts

Figure 1 shows that the development of debt to GDP ratios of the G7 countries and Spain since the 1970s differs considerably between these countries. The increase is most markedly in Japan which actually demands an own (the right-hand) scale in the left panel of Figure 1. At almost zero percent in 1970, Japanese public debt rose with little consolidation in the second half of the 1980s to about 250 percent of GDP in 2017. In the U.S., total government debt of all levels of government rose from about 1980 with consolidation in the second half of the 1990s to about 100 percent today. In Canada, this increase since 1980 was even stronger, consolidation in the 1990s until the Great Recession more thoroughly and the subsequent increase less considerable than in the U.S., such that the Canadian debt to GDP ratio is at about the same level as the U.K's. The U.K. has mainly suffered from the increase of the debt to GDP ratio induced during the Great Recession.

Regarding EMU member countries, an increasing trend is most obvious in France with almost no consolidation during these 47 years. Spain and Italy display increasing trends in their debt to GDP ratios until entering EMU, consolidating more or less, respectively, until the Great Recession, giving way for increasing debt again afterwards. While Italy with 132 percent has one of the highest levels of public debt to GDP in EMU, Spain and France have arrived at similar levels of almost 100 percent. Germany shares France's increasing trend of public debt to GDP until the Great Recession, but deviates after 2009 with considerable consolidation of almost 20 percentage points.

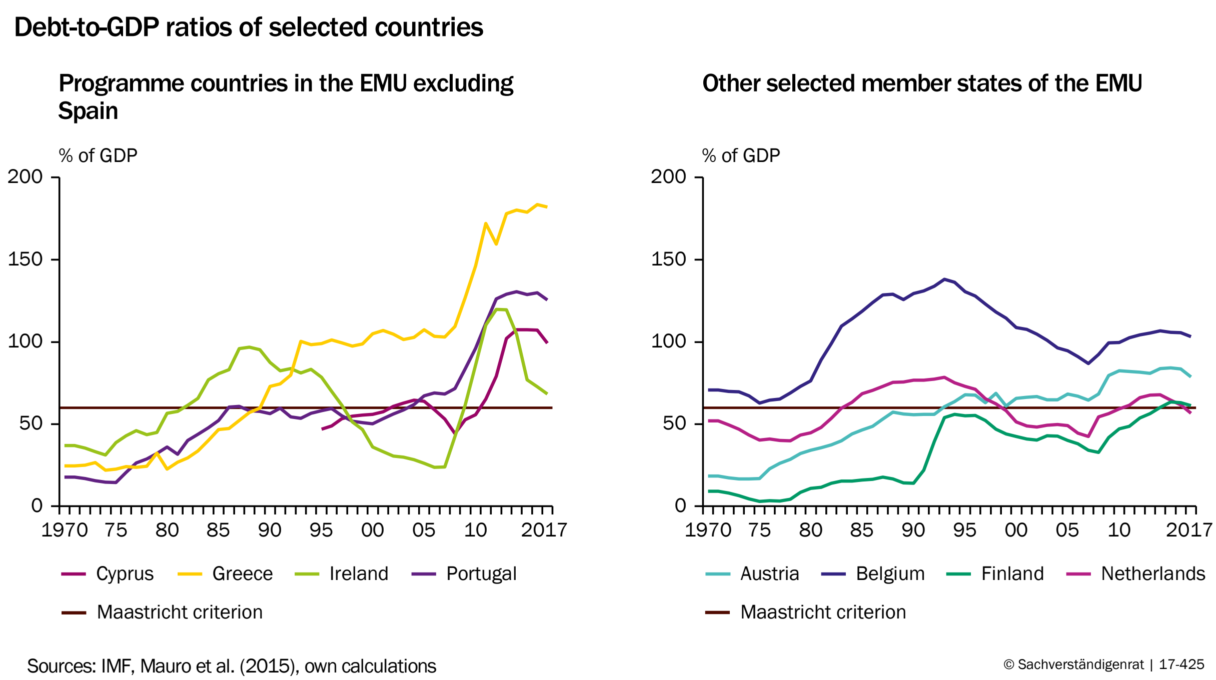


Figure 2: Debt to GDP Ratios of Small OECD Countries, 1970 – 2017

Source: German Council of Economic Experts

Figure 2 shows the debt to GDP ratios of eight small member countries of EMU with the so called program countries, those countries that underwent an adjustment program during the Eurozone crisis, displayed in the left panel of Figure 2, and four other members of EMU in the right panel. The strong increases in debt to GDP ratios in Greece, Portugal and Cyprus are obvious, not only after the Great Recession, but also during the 1970s and 1980s. Ireland had a similar experience in the 1970s and 1980s, but started a period of strong consolidation in the second half of the 1980s that endured until the eve of the Great Recession. The tremendous increase of its public debt to GDP ratio during the Eurozone crisis has been followed by remarkable consolidation afterwards.

In Austria and Finland, debt to GDP ratios rose since 1970 with some fluctuations, but without clear-cut consolidation (see Figure 2, right panel). This is different in the Netherlands and Belgium which both experienced strong increases in government debt until the middle of the 1990s, considerable consolidation until 2007, a further surge in public debt after the Great Recession and some consolidation of its fiscal policies recently. The Netherlands managed to keep these fluctuations around the threshold of 60 percent debt to GDP ratio stipulated by the Maastricht Treaty and the Stability and Growth Pact. Belgium, however, started with a debt to GDP ratio of about 140 percent into EMU and reduced it to about 90 percent until 2007. Belgian debt meanwhile is at 100 percent of GDP.

This comparative exercise underlines several facts. First, there is an overall increasing trend in government indebtedness in percent of GDP in OECD countries. Almost all countries start from lower levels of debt to GDP in 1970 than they arrive at in 2017. Secondly, there are remarkable differences between those OECD countries. Debt to GDP ratios vary between 60 percent in Germany and the Netherlands and 250 percent in Japan. In Switzerland (not shown), it is even 35 percent only. Thus, the question emerges what is the reason for this variation and for the increasing trends. Alesina and Perotti (1995) arrived at the same observations and the same questions more than 20 years ago. Not much seems to have changed since, despite all fluctuations across time – except that the levels of the debt to GDP ratios are higher. These are only first impressions of a possible deficit bias in fiscal policies of OECD countries that must be further addressed in this paper. Before we consider this question, it is however necessary to look at the sustainability of public debt.

3. The Sustainability of Public Debt

Analyses on debt sustainability provide insights as to the extent to which public debt is shifted to future generations because they include many relevant aspects discussed in the old debate about burden shifting. If public debt is used for productive government spending, it can increase growth in the long-run, facilitating payments of interest and principal. The term productive spending avoids classifying it into public investment or public consumption as both can be productive or unproductive depending on what the government actually spends money. Paying teacher salaries can economically be an investment in school children's human capital as higher teacher salaries may attract better teachers, but it legally is public consumption. A bridge to nowhere is however unproductive although it is investment spending.

Of course, such a perspective does not fully acknowledge the different arguments brought forward in the burden shifting debate, in particular not Buchanan's (1958, 1964) arguments. Yet, it indicates whether a country runs into the danger of exploding debt levels leading to sovereign default or sovereign debt restructuring. The most recent examples of Greece or Argentina illustrate what default implies for current generations if past governments of their countries followed irresponsible fiscal policies. The hardship current generations in these countries have had to undergo impressively illustrates what a burden of public debt means: Excessive public debt heavily reduces the fiscal space of those generations.

Economists have been concerned with the sustainability of public debt for a long time (see Domar 1944, Blanchard et al. 1990, Blanchard 1993). These analyses start from the intertemporal government budget constraint according to which a state, in contrast to private households or firms, will have to repay its debt only in the very long-run, i.e., in infinity. Public finances will be sustainable if

$$d_0 = -\sum_{t=1}^{\infty}\left(\frac{1+y}{1+r}\right)^t p_t + \lim_{T\to\infty}\left(\frac{1+y}{1+r}\right)^T d_T \tag{1}$$

with y as the growth rate of real GDP, d the debt to GDP ratio, r the real interest rate, p the primary balance and t the respective time period. This equation can be expressed in nominal terms allowing for an additional analysis of seigniorage.

Accordingly, government finances are sustainable if future primary surpluses in an infinite time horizon can cover government debt accumulated in the past. The ability to generate primary surpluses depends on real economic growth, i.e., the potential to raise revenue, and is counteracted by the real interest rates that must be paid to service debt. Already Domar (1944) shows that the necessity to generate primary surpluses depends on the relation between interest rates and economic growth. If the growth rate of GDP is higher than the interest rate, the debt to GDP ratio declines across time without primary surpluses. If the interest rate is higher than the growth rate of GDP, government must realize primary surpluses. Otherwise, the debt to GDP ratio will grow with continuous acceleration until the system collapses.

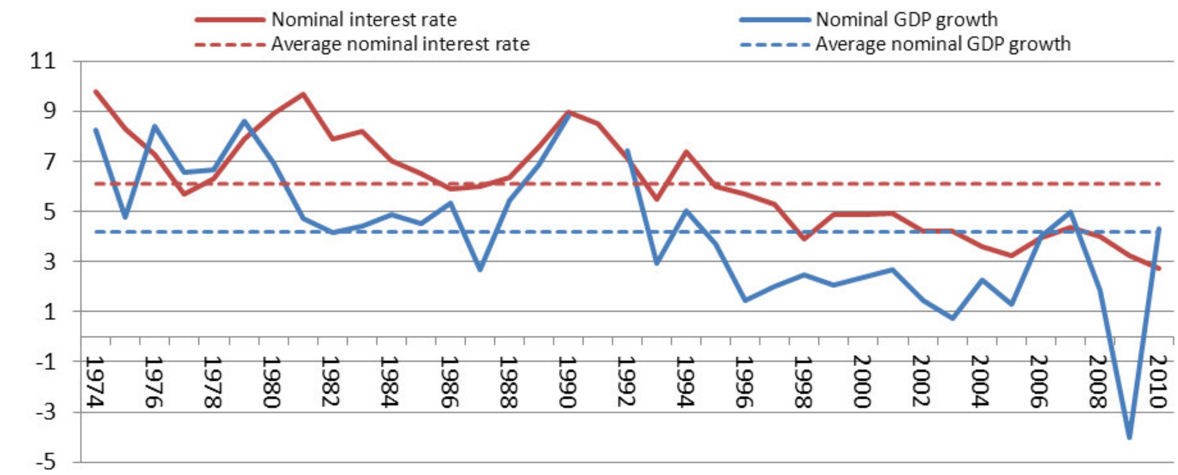


Figure 3: Nominal Interest Rates and Growth Rates of Nominal GDP in Germany, 1974 – 2010; Source: German Council of Economic Experts

Figures 3 to 6 illustrate the movement of both time series, i.e., nominal interest rates and the growth rates of nominal GDP for Germany. Figure 3 covers the years between 1974 and 2010. During this time-period, Germany experienced notable economic shocks, namely the oil price and unification shocks, and entered a period of moderate economic growth. Aside yearly movements, the nominal interest rate was higher on average than the growth rate of real GDP. Given that during the same period an increasing trend in the debt to GDP ratio has obtained, it is natural that policymakers have become concerned with this development and introduced a debt brake into the German constitution (the Basic Law) in 2009.

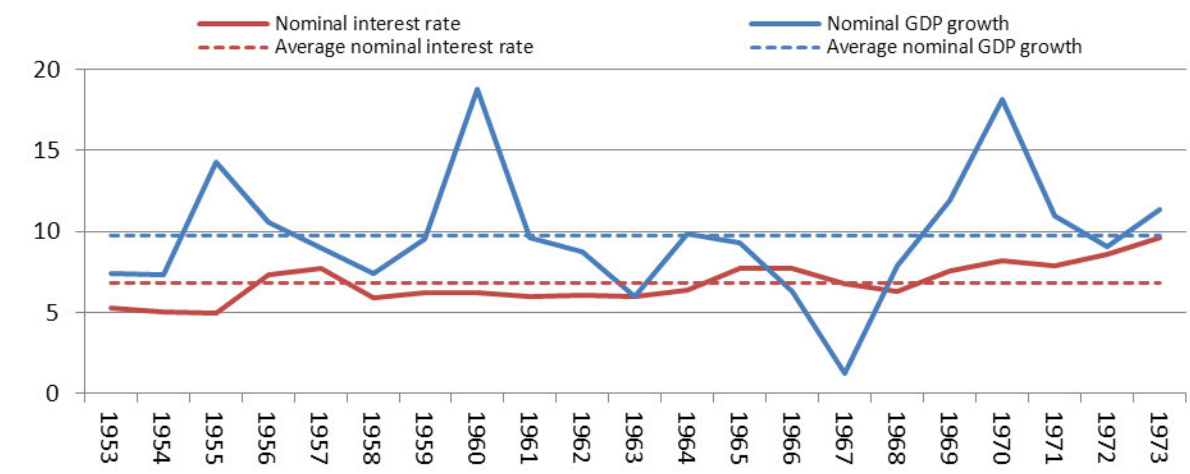


Figure 4: Nominal Interest Rates and Growth Rates of Nominal GDP in Germany, 1953 – 1973; Source: German Council of Economic Experts

The situation was quite different in the two decades before (see Figure 4). After the Second World War, in its economic miracle years, the German economy grew with much higher rates, partly due to a rebuilding of the economy and other catch-up effects. Figure 4 shows that on average the growth rate of nominal GDP was higher than the nominal interest rate. The debt to GDP ratio remained flat despite the budget deficits that occurred from time to time. Public debt appeared to be financed by the growth of the economy.

It is difficult to judge whether the period between 1974 and 2010 or that between 1953 to 1973 is normal for Germany. It is essential for the sustainability of public finances that the interest rates in the intertemporal budget constraint, which are used to discounting the future values of the aggregates in equation (1), are high enough to obtain finite present values of these aggregates such that the infinite series of these flows converge absolutely (Homburg 1991). This is usually the case if the interest rate is higher than GDP growth, but not if the interest rate is lower. Theoretically, thus, much speaks in favor of the later period to reflect a rather normal situation. Figure 5 picks up the time before the First World War between 1871 and 1914 showing that during the gold standard, Germany had higher interest rates than GDP growth on average. This may serve as an additional illustration of the theoretical arguments.

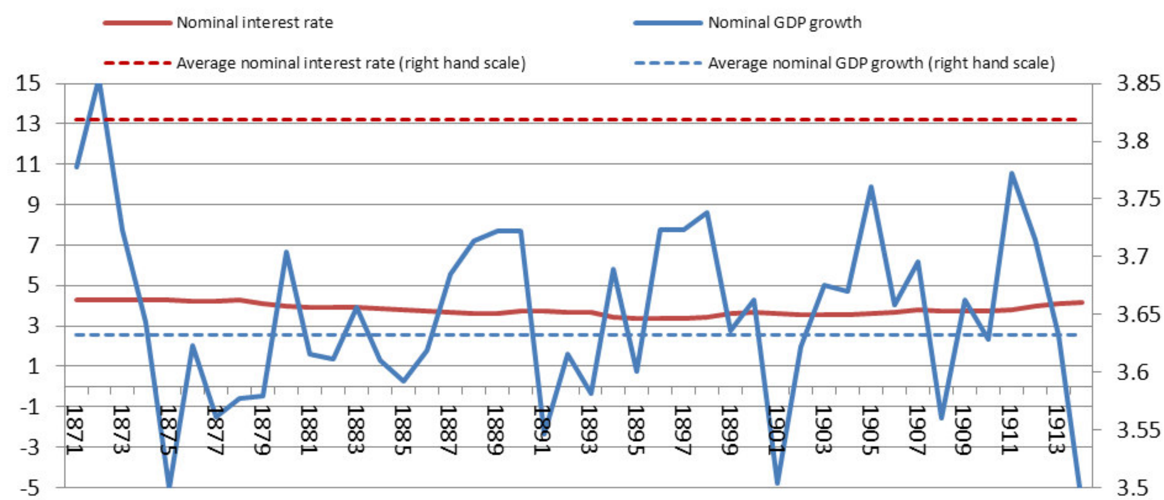
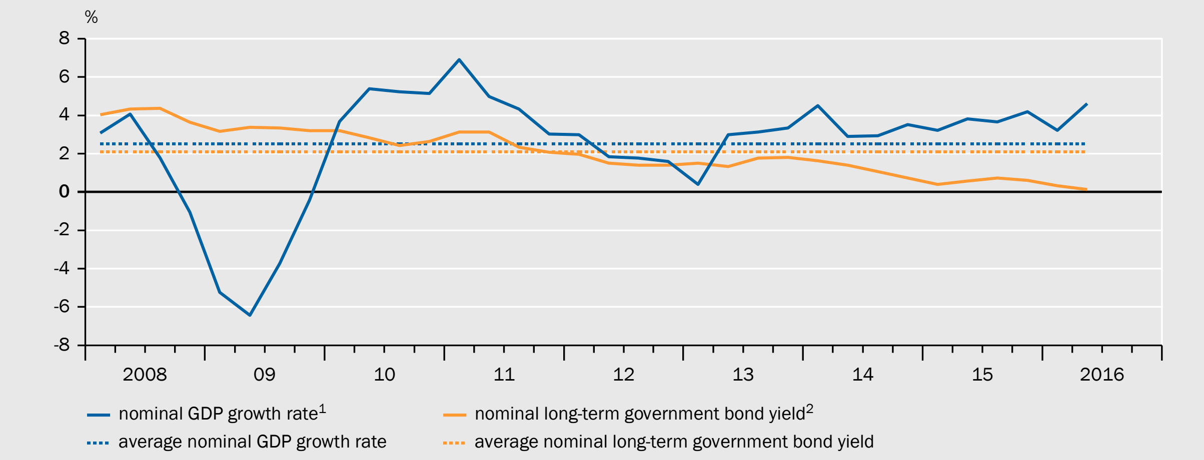


Figure 5: Nominal Interest Rates and Growth Rates of Nominal GDP in Germany, 1871 – 1914; Source: German Council of Economic Experts

However, infinity is a sequence of finite steps. Economic shocks may hit the flows of fiscal aggregates frequently and thus require fiscal counter-action to help the economy recover from a shock. Figure 6 shows the German experience from 2008 to 2016. The German economy was hit by two shocks, first, the Great Recession in 2008 and, second, an interest rate shock as Germany has served as a safe haven during the Euro-crisis. On average, nominal interest rates are therefore somewhat lower than GDP growth since the financial crisis, allowing for a consolidation that relies on lower interest payments and higher public revenue.

GDP growth rate and long-term government bond yield for Germany



1 – Year-on-year change. 2 – Maturity over 9 to 10 years.

Source: Deutsche Bundesbank, Statistisches Bundesamt

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Figure 6: Nominal Interest Rates and Growth Rates of nominal GDP in Germany, 2008 – 2016; Source: German Council of Economic Experts

Against this background, there are several test strategies in the empirical literature assessing fiscal sustainability ex post. One test strategy consists in stationarity tests on public debt and budget deficits. Public finances are sustainable if these series are stationary. In addition, cointegration tests of public debt and budget surpluses on the one hand or between public revenue and spending on the other hand are conducted. The estimation of Vector Error Correction Models (VECM) helps to identify long-run relations and short-term deviations. The question underlying these analyses is whether current public debt is equivalent to discounted future primary surpluses, i.e., the intertemporal budget constraint. The necessary condition for fiscal sustainability is thus tested. Burret, Feld and Köhler (2013, 2016, 2017) report such analyses for Germany and conclude that neither total government finances nor those of the Laender (states) are sustainable.

A second test strategy estimates linear fiscal reaction functions. If there is a positive reaction of primary balances on the level of public debt, then a sufficient condition of fiscal sustainability obtains (Bohn 1995, 1998, 2008). The basic idea of this test strategy is compatible with the argument that such reactions reflect the ability of governments to redeem their debt in the future. This ability also includes the possibility to overcome political economy problems. Potrafke and Reischmann (2014) test sustainability of German Laender finances using this approach and find out that they are sustainable if the German fiscal equalization system is considered, while Feld et al. (2018) suggest that they only partly meet the criteria for fiscal sustainability even in the case with fiscal transfers.

The third test strategy follows a structural approach using Dynamic Structural General Equilibrium (DSGE) Models (D'Erasmo et al. 2016). Economic growth and interest rates are endogenous in these models. The endogeneity of interest rates to the fiscal and the economic situation of a country is reflected in the expectations of market participants. If theoretical arguments are taken seriously, in a situation of interest rates higher than GDP growth, a government cannot redeem its loans by issuing new debt forever. If market participants doubt the repayment of a country's loans, potential creditors only hesitantly buy government bonds inducing interest rates to rise, leading to further creditors to withdraw and so on (Calvo 1988, Morris and Shin 1998). It is obvious that the possibility for a state to play a Ponzi game is restricted and depends on its credibility. If credibility is lost, financial markets quickly switch from a situation in which government finances look sustainable to a situation with sky-rocketing refinancing costs and fully unsustainable finances. This credibility rests on political economy and institutional environments.

4. Explanations of Public Debt

Given this pattern of the development of public debt across OECD countries and the discussion of the sustainability of public debt, it is important to find out what are the economic and institutional factors explaining public debt and thus shape its sustainability. For Buchanan (and many other public choice scholars), based on experience with public debt in OECD countries at earlier times (Buchanan 1968, 1997, Buchanan and Wagner 1977), it may have been obvious that the evidence alluded to in the previous two sections supports the notion of excessive indebtedness. His Keynesian critiques would however hold that much of the movements of public indebtedness are due to the cyclical movements of the economy and are needed to contribute to economic stabilization.

Can cyclical movements indeed explain the variation of public debt of OECD countries across time and space? Standard textbook knowledge suggests that business cycles certainly play a role, at least when the built-in-flexibility of government budgets is allowed to work. In a recession, public revenues decline and expenditures increase. A recession involves less aggregate income of an economy, hence less (personal and corporate) income tax revenue and social security contributions. On the spending side, higher unemployment rates, for example, trigger higher aggregate spending for the unemployed if there are unemployment insurance schemes. Usually, such automatic stabilizers are supposed to work without the government trying to counteract them with tax increases or spending reductions, as this would potentially deteriorate the economic situation further. Moreover, the extent of automatic stabilizers is different in different countries. European welfare states have more automatic stabilization at their disposal than the U.S. for example.

A recent prominent explanation of the variation of public debt across time and countries consists in financial and banking crises. Schularick and Taylor (2012) provide evidence that such shocks play an important role for cyclical movements. In contrast to other demand or supply shocks, banking crises are frequently accompanied by longer periods of moderate economic growth because the consolidation of the banking sector takes time.

Another obvious reason for higher government debt consists in singular events that hit a country like a purely economic shock. Wars and violent conflicts belong into this category as do natural disasters like, e.g., earthquakes, extreme weather events, floods or draughts. In the case of Germany that featured as an illustrative case in previous sections, unification of West and East Germany in 1990 was such a singular event leading to an increase of debt because of immediate financing requirements that would have been difficult to obtain via tax increases.

Other traditional explanations for public debt are public investment and demographic change. According to the golden rule of public investment, a government should finance its investment projects with debt because the resulting public infrastructure serves future users as well. A distribution of the costs of public infrastructure across time requires future users to pay their fair share of an infrastructure that is useful for them. The golden rule actually is a normative argument like the recommendation to let automatic stabilizers work. Both additionally provide positive explanations regarding the extent to which public debt can be explained by business cycles and public investment. In the case of demographic change, the positive question dominates as to whether ageing societies are under pressure to finance larger parts of social security with higher indebtedness. Given that demographic change will mainly take place in future decades in most OECD countries, with the notable exception of Japan, it has probably less explanatory power for past public debt increases.

Empirically, these traditional economic approaches explain the increasing trend of government debt and its variation across countries to some extent. In particular, economic shocks in the sense of cyclical movements, singular events or banking crises are important explanatory factors. This does not hold with respect to public investment. The increasing trend of public debt since the 1970s is accompanied by a decreasing trend in public investment in most OECD countries. Demographic change has some explanatory power in the case of Japan, but less in other countries in which ageing sets in later.

Still, such explanations of the variation in public debt are incomplete. In particular, the question emerges as to why public debt increases in recessions or due to singular events, but is not reduced in booms or when the economic effects of singular events are overcome. What are the factors preventing a government from consolidating its budget in better times? Buchanan and Wagner (1977) hold Keynesianism responsible for excessive indebtedness. In the early days of Keynesian macroeconomic policy, when the U.K. and the U.S. endorsed it in the 1950s and 1960s, the effects on public debt were still low, partly because of relatively high inflation in both countries, partly because of overall stronger economic growth. When Keynesian recipes were applied in the 1970s, after the breakdown of the Bretton Woods system, stagflation emerged, showing how such policies can fail, also giving way to the increasing debt dynamics shown in Section 2. However, this reasoning is also incomplete as it is particularly the lacking consolidation in good times that requires an explanation. Keynesianism may have abolished the informal (moral) rules of sound fiscal policy that existed before and thus provided the general environment for profligacy (Buchanan 1985, 1987). As an explanation for actual debt variations it is insufficient.

This leads to the more recent analyses in political economics. Alesina and Pessalacqua (2016) provide a comprehensive survey on the political economy of government debt. They ask whether the observed pattern of government indebtedness is excessive. Optimal debt is obtained on the basis of tax smoothing that proposes to cope with transitory shocks by allowing for budget deficits instead of tax rate changes in order to minimize the excess burden of taxation (Lucas and Stokey 1983). Alesina and Pessalacqua (2016) conclude that optimal debt theory is not supported by the data implying that government debt is excessive, i.e., there is a deficit bias in fiscal policy. Consequently, they consider different arguments from political economics to close the explanatory gap between actual (excessive) debt and optimal debt levels.

Without providing a comprehensive account, two different political forces play a particularly important role: Elections and common pool problems. Elections could have two different effects. On the one hand, governments have incentives to spend before elections in order to ensure voter support (see, e.g., De Haan and Klomp 2013, Foremny et al. 2018). After elections, some of this additional spending is partly compensated for by a budget consolidation that is however weak, for example, because of tax resistance. Overall, public debt may increase across time. On the other hand, governments may act strategically before elections. Anticipating that it is probably not reelected, a governing party may leave its successor less fiscal space restricting its ability to keep its election promises, hence increasing reelection of the current governing party at the next election (see, e.g., Pettersson-Lidbom 2001). Strategic government debt may require highly rational policy-makers, but it can also potentially explain increasing trends in public indebtedness because excessive debt of the current government to bind the next government does not prevent the latter from trying to keep as many of its election promises as fiscal space allows.

Common pool problems are another powerful public choice explanation of excessive public spending and public debt. The basic idea is going back to Buchanan and Tullock (1962), but is more fully examined by Weingast et al. (1981) regarding spending and Velasco (1999, 2000) regarding public deficits and public debt. A common pool problem emerges if different groups have access to a common resource, in our case the budget, and try to obtain as many favors as possible. Each group exerts its demand for public funds until the marginal benefits of obtaining such funds equals the marginal costs of the financial contribution of the group to the budget. A spending bias emerges because some groups have better access to the budget than others such that benefits are concentrated and financing costs are distributed over a larger population. Improved access is obtained through log-rolling between legislators or coalitions between parties. If the financing of current spending that triggers benefits for those groups can be spread to future taxpayers who cannot participate in today’s decisions, the incentives for excessive spending may even be higher. Such excessive spending is accompanied by excessive indebtedness. Moreover, this reasoning offers a particular twist regarding fiscal consolidation. In case, a government wants to consolidate the budget, the different beneficiary groups will oppose it and obstruct the consolidation goals.

The common pool problem has different faces. It might be the result of log-rolling between legislators in parliament, an exercise common in U.S. Congress, but frequently present in other political systems too (for the not fully conclusive evidence, see, e.g., Egger and Köthenbürger 2010 versus Pettersson-Lidbom 2012). The role of fragmented government is also discussed regarding coalition governments (Roubini and Sachs 1989a, b, De Haan and Sturm 1994, De Haan et al. 1999) or regarding cabinet size (Perotti and Kontopoulos 2002, Schaltegger and Feld 2009a, Fritz and Feld 2015). In the previous case, the coalition treaty between the government parties is a form of explicit log-rolling. In the latter case, each spending ministry induces the overuse of the fiscal commons while the finance ministry is supposed to have a gate-keeping role.

Buchanan (1997, pp. 497) summarizes the basic problem why ordinary politics cannot balance the budget formidably:

> *"Government spending for a wide array of "goods" may be authorized, and every one of these "goods" may be valued positively by some or all constituents. The approval of these rates of spending may, however, proceed without explicit regard to the genuine opportunity cost that must ultimately be measured in the sacrifice by someone, sometime, of other values that might have been produced. It is not the public spending, as such, that is the proper focus of attention here. ... That which makes the existing rules generate patterns of outcomes that we deem to be irresponsible is the political agents' authority to spend without taxing. Little or no sophistication is required to recognize how different the dynamics of the fiscal choice would be in a constitutional setting that forced politicians to levy taxes to cover outlays."*

He further emphasizes again that the opportunity costs of public spending are shifted to future generations because those who give up resources today, i.e., the lenders do so in exchange for valued claims, e.g., government bonds, against future taxpayers, who will have restricted fiscal space to serve their own spending needs. The interaction between burden shifting of government debt, with which Buchanan's analysis started 60 years ago, and the political economics of public debt is obvious from these quotes. The conclusion that must be drawn from this analysis is also straightforward: The constitutional setting must be changed.

5. Institutional Restraints on Public Debt

If public choice mechanisms are a reason for the deficit bias in fiscal policies, institutions must indeed play a role for the variation in public debt to GDP ratios that is observed across time and countries. Moreover, institutions should affect the expectations of financial markets regarding the sustainability of public debt in the sense that a country is willing and able to service its debt. Such reasoning offers chances for positive analysis, but also leads to the normative question as to how a democratic regime should be designed in order to induce sound fiscal policies.

The first step of such a positive analysis is a comparison of public debt between different constitutional systems. Persson and Tabellini (2003) hypothesize the different incentives in majoritarian vs. proportional representation systems and in presidential vs. parliamentarian democracy as well as the interactions between these regimes. They argue that public debt will be higher in parliamentarian and proportional representation systems because these systems favor broad-based redistributive systems and higher political rents. The evidence regarding differences between these systems is however inconclusive as, e.g., neither Funk and Gathmann (2013) nor Pfeil (2017) can support their analysis. A reason may be that log-rolling and pork-barrel politics may be similarly strong, though different in those systems.

The evidence is much more conclusive regarding the comparison between direct and representative democracy. The literature focuses on the effects on particular referendums, for example, the Swiss fiscal referendum as a veto instrument. If spending exceeds a certain threshold, a fiscal referendum must be held. The type of spending that usually induces such fiscal referendums is investment spending which is often financed by public debt. More generally, however, the possibilities for log-rolling and pork-barrel politics are lower in referendums and initiatives as compared to parliament. It is thus no surprise that evidence speaks in favor of a lower deficit bias in direct democracy (Kiewiet and Szakaly 1996, Feld and Kirchgässner 2001a, Blume et al. 2009, Feld, Kirchgässner and Schaltegger 2011).

Federalism vs. unitarianism provides for another prominent system comparison. The difficulty in that comparison results from the many characteristics of the different federalisms around the world. There are systems of cooperative federalism in which tax and spending responsibilities are not properly assigned such that liability and control deviate at the different government levels. An example is Germany with its strongly egalitarian fiscal equalization system, highly centralized taxing and decentralized spending powers. In systems with taxing and spending powers assigned to each level of government, a stronger fiscal competition results. Such types of competitive fiscal federalism do not restrict consolidation efforts of governments and have lower public debt (Schaltegger and Feld 2009b, Foremny 2014, Asatryan et al. 2015).

Aside from these overall system comparisons, fiscal rules figure prominently in the discussions about institutional constraints on excessive spending and excessive indebtedness. The early literature on balanced budget rules in the U.S. is ambiguous with respect to its spending effects (Kirchgässner 2002), but more conclusive regarding public debt (Bohn and Inman 1996, Burret and Feld 2014). These early analyses on the effects of fiscal rules show that much depends on their design. Simple rules, rules that are too crude, offer many possibilities to circumvent them (von Hagen 1991). Bohn and Inman (1996) have thus offered a list of characteristics of balanced budget rules in the U.S. that seemed to have worked. One such characteristic is that they are fixed at the constitutional level, a proposal that Buchanan has supported again and again.

Similarly, the more recent discussion about second generation fiscal rules asks for sophisticated rules, like the Swiss or German debt brakes (Eyraud et al. 2018). Both fiscal rules, having a broad coverage in general, require an (almost) balanced budget across the business cycle, i.e., structural budget balance, such that automatic stabilizers are allowed to work. They allow for well-defined escape clauses as additional, but clearly defined exceptions to the rule in which deficits may be higher. Budgeting mistakes are accounted for on a separate adjustment account and must be balanced after a certain time. And, following Buchanan (1997), they do not allow for deficits to cover investment spending.

The Swiss federal debt brake has been inspired by cantonal fiscal rules that effectively restrain cantonal public debt (Feld and Kirchgässner 2001b, 2008, Krogstrup and Wälti 2008, Burret and Feld 2018a, 2018b). Feld et al. (2017) provide evidence that these cantonal debt brakes, in addition to the credible no bailout clauses, reduce risk premia of the Swiss cantons. Pfeil and Feld (2016), using the Synthetic Control Method, present evidence that the Swiss federal debt brake reduced the cyclically adjusted budget balance. In a meta-analysis, Heinemann et al. (2018), considering 25 studies with 889 observations, show that fiscal rules have a significantly negative correlation with primary deficits and budget deficits. Overall, this broad research outcome strongly supports Buchanan's (1997) claim for a balanced budget amendment.

6. Conclusion

James Buchanan pioneered the political economics of public debt. Buchanan (1958) was concerned with a shifting of the debt burden to future generations, Buchanan and Wagner (1977) accused Keynesianism of being responsible for fiscal profligacy. Keynesian follies undermined the informal (moral) rules of fiscal prudence that prevailed before the Keynesian revolution set in (Buchanan 1985, 1987). Buchanan's (1997) conclusion was straightforward: Informal rules that shaped fiscal policy in many countries until the 1960s should be replaced by formal rules, i.e., balanced budget amendments to constitutions or, in general, fiscal rules.

In this paper, we have traced the development of public debt in OECD countries across time raising first concerns of excessive indebtedness in those countries. A discussion of the sustainability of public finances indicates that there is a shift of public debt to future taxpayers in particular when they face the danger of financial markets withdrawing their confidence in a country's willingness or ability to pay. There are traditional economic reasons for public debt (business cycle, public investment, particular single events (unification, natural desasters)), but they cannot explain lacking consolidation in better times. Two political-economic explanations particularly add to the understanding of excessive debt: Elections and common pool problems. Institutional rules influence whether such political economics mechanisms more or less severely affect fiscal policy. According to the recent evidence, well-designed fiscal rules help to obtain sound public finances.

In sum, it seems as if Buchanan's thinking about public debt had finally convinced policy-makers and constituencies around the world. Many countries, in particular in Europe, have introduced fiscal rules or improved existing rules. However, Leviathan lives on and particularly fights back since the Great Recession. Anyway, I found out that Jim Buchanan was in a good intellectual neighborhood to one of the leading classical liberals in Switzerland in the 19th century. In his book, *Weltgeschichtliche Betrachtungen* Jakob Burckhardt (1921, p. 132, my translation) wrote: "*We should anyway shut up against the middle ages, as those times did not bequeath public debt to their successors*."

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Feld has been, since 2003, a member of the Scientific Advisory Council to the Federal Ministry of Finance, Germany, and, since 2011, a member of the German Council of Economic Experts (GCEE). He currently represents the GCEE in the Independent Advisory Council of the Stability Council. In 2017, he received an honorary doctorate from the University of Lucerne in Switzerland.

Turning Freedom into Action: some Reflections on Reforming Higher Education

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Turning freedom into action requires urgent reforms in higher education, both in the United States and elsewhere. Universities train future political leaders, captains of industry, as well as the next generation of teachers and university professors. If, as is increasingly the case, universities do not instill in students the fundamental principles of free inquiry, the future of freedom itself will be bleak. It is therefore imperative that universities be reformed so that meaningful critical thinking can once again flourish at these institutions.

In my view, reform should focus on four areas:

- The curriculum
- Distinguishing between “education” and “indoctrination”
- The professoriate: ensuring a healthy openness of discussion, free inquiry, and ideological diversity
- Boards of trustees: making sure they reclaim a measure of the power they have ceded, until now, to increasingly ideological administrators.

Background

In 2017, a representative survey in the UK found that 70 per cent of university students who were likely to vote were planning to vote for Jeremy Corbyn’s Labour Party.[1] Even then, Corbyn was a polarizing figure in British politics, with a track record of support for, and ideological associations with, extreme groups including Hamas.[2] By 2019, this previously strong Labour support among university students had fragmented. Of those students who indicated they were likely to vote in 2019:

- 38% stated they would vote for the Labour Party;
- 19% for the Liberal Democrats;
- 18% for the Green Party;
- 12% for the Conservatives[3]

From 2015 through 2019, Labour was the clear favorite among students likely to vote, despite the well reported problems in the Party associated with anti-Semitism and support for Islamism.[4]

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[1] https://www.timeshighereducation.com/news/labour-support-among-uk-students-nearly-halves-18-months

[2] Simcox, Robyn. “Jeremy Corbyn has a soft spot for extremists.” *Foreign Policy.* < https://foreignpolicy.com/2018/10/03/jeremy-corbyn-has-a-soft-spot-for-extremists-ira-hamas-hezbollah-britain-labour/>

[3] https://www.timeshighereducation.com/news/labour-support-among-uk-students-nearly-halves-18-months

[4] https://www.timeshighereducation.com/news/labour-support-among-uk-students-nearly-halves-18-months
Ambrose, Jillian. 2019. “Corbyn nationalization plans for energy sector to collide with international treaties.” *The Guardian.* < https://www.theguardian.com/business/2019/nov/28/corbyn-nationalisation-plans-for-energy-sector-to-collide-with-eu-law-labour>

The popularity of hard-left candidates such as Jeremy Corbyn among British university students over the years raises serious questions about the state of critical thinking and intellectual freedom, and intellectual diversity in Britain's universities. And the problem is not confined to the UK.

In the United States, college students overall appear to be less left-wing and more diverse in their stated political affiliation than their British counterparts.[5] Yet freedom of expression on American college campuses is under growing threat, usually from those who favor a radical understanding of the term "social justice," one focused on the idea of "intersectionality" and the collective victimhood of certain social groups.

Although a majority of American college students—slightly less than 6 in 10—find that "hate speech," defined as "attacks [on] people based on their race, religion, gender identity or sexual orientation," ought to be protected by the First Amendment, 41 per cent *disagree*.[6]

More than two-thirds (68 percent) of American college students say their campus climate precludes students from expressing their true opinions because their classmates might find them offensive.[7] Numerous incidents in recent years point to a climate of intolerance on many university campuses and not only towards conservatives.[8]

At the same time, young Americans overall (not just university students) have surprisingly positive views about socialism. In 2018, Americans aged 18 to 29 who were surveyed stated they were more positive about socialism (51%) than they were about capitalism (45%).[9]

What about other countries? Reliable, representative data is not universally available, but in Australia a 2019 survey of 500 students found that 41 per cent of students felt they were sometimes unable to express their opinion at university, while 31 per cent had been made to feel uncomfortable by a university teacher for expressing their opinion, and 59 per cent believed they were sometimes prevented by other students from voicing their opinions on controversial issues.[10]

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[5] https://www.theatlantic.com/education/archive/2017/05/the-most-polarized-freshman-class-in-half-a-century/525135/
https://www.heri.ucla.edu/monographs/TheAmericanFreshman2016.pdf

[6] https://kf-site-production.s3.amazonaws.com/media_elements/files/000/000/351/original/Knight-CP-Report-FINAL.pdf P. 10.

[7] https://kf-site-production.s3.amazonaws.com/media_elements/files/000/000/351/original/Knight-CP-Report-FINAL.pdf P. 12

[8] Jaschik, Scott. 2018. "Evergreen calls off 'day of absence.'" *The Chronicle of Higher Education*. < https://www.insidehighered.com/news/2018/02/22/evergreen-state-cancels-day-absence-set-series-protests-and-controversies>
Stanley-Becker, Isaac. 2015. *The Washington Post*. "Yale instructor at the center of racial protest to leave teaching role." < https://www.washingtonpost.com/news/grade-point/wp/2015/12/04/with-her-words-this-instructor-helped-set-off-protests-over-race-and-a-debate-over-free-speech-now-shes-leaving-yale/ >

[9] https://news.gallup.com/poll/240725/democrats-positive-socialism-capitalism.aspx

[10] https://ipa.org.au/publications-ipa/media-releases/free-speech-crisis-at-australias-universities-confirmed-by-new-research

The irony of this is that universities are supposed to be—in theory—bastions of free inquiry and critical thinking. Although there appears to be a lot of criticism of Western civilization and the free enterprise system, there is little diversity of opinions or tolerance of different points of view, let alone critiques of non-Western civilizations.

To improve the current state of affairs, I highlight four areas of reform below.

1) Curriculum

For a student to be able to think critically, a student has to possess a basic knowledge as well as a basic understanding of Western history and Western civilization. Although critical thinking certainly includes critiquing Western civilization, a measure of realistic self-criticism should never descend into nihilism, for instance ignoring abuses of non-Western civilizations while emphasizing only the dark chapters of Western civilization.[11] Pascal Bruckner has called this tendency the "masochism of the West," and he has a point.[12] Here, an irony arises: today there is a great deal of criticism of Western civilization in American and British universities, while other subjects, such as the behavior of the Prophet Muhammad or the early phase of Islamic military conquests, are increasingly immune from criticism.[13] In my view, it is not sensible to have civilizational criticism go only in one direction.

There is another irony. Even as criticism of "Western civilization" is on the rise, familiarity of students with the core texts of "Western civilization" appears to be in decline. Not that long ago, a basic understanding of Western civilization was assumed to belong in a standard university curriculum. By all means, Western Civilization courses in the past had their own agendas but rightly understood, a rigorous university curriculum should emphasize knowledge of the classics, the great literary products of Western civilization, as well the aesthetic beauty of Western art. Yet in recent decades, this common assumption has disintegrated at many American universities. An added problem is that the harshest critics of Western civilization do not present feasible alternatives to, say, the market economy and democracy, only criticism, which if taken to extremes can lead to a type of nihilism.[14]

Here at Stanford University, in January of 1987, as many as 500 students, along with the Reverend Jesse Jackson, marched down Palm Drive chanting, "Hey hey, ho ho, Western Civ has got to go," and demanding that Stanford's standard required course in Western civilization be fundamentally transformed. There have been similar protests at other universities throughout the years. In 1989 Stanford's traditional Western Culture program was formally replaced with the Cultures, Ideas, & Values (CIV) program that included what the university euphemistically called "more inclusive" works on race, class, and gender.[15]

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[11] See for instance: Sandall, Roger. 2001. *The Culture Cult: Designer Tribalism and Other Essays.* New York: Routledge.
[12] Bruckner, Pascal. *The Tyranny of Guilt: an Essay on Western Masochism.*
[13] See: Shoemaker, Stephen J. 2018. "Muhammad" in *The Routledge Handbook on Early Islam* ed. Herbert Berg. Routledge: New York. P. 49-64.
[14] See: Scruton, Roger. 2017. *Fools, Frauds and Firebrands: Thinkers of the New Left.*
[15] https://exhibits.stanford.edu/stanford-stories/feature/1980s

Stanford's curriculum reform, which was also implemented at many other universities in various forms, helped to empower "critical" race theory, "critical" gender studies, and "critical" sexuality studies. Many of these "critical" disciplines teach a particular perspective on the part of opinionated and highly ideological instructors, from a viewpoint of moralistic superiority that brooks little dissent and, it must be said, even less critical thinking about the premises on which they are based.[16]

In that sense, the 1980s—although in many ways a conservative decade politically that culminated in the collapse of the Berlin Wall and the demise of East bloc Socialism—were also a time when many American universities reduced their commitment to traditional Western values.[17]

2) Distinguish between education and indoctrination

Those involved in higher education should move towards a better understanding of what it means to be college-educated. It has been said that education opens the mind, while indoctrination closes it. A good education permits one to think critically, and to consider multiple viewpoints. A good education ought not to result in nihilism, or total relativism, or the urge to "de-construct" all that is beautiful and sublime in Western (or any other) civilization.

At many American universities today, there is a growing focus on the pursuit of what is called "social justice" rather than the pursuit of objective truth, an appreciation of beauty, or an understanding of the classics. In many university departments, the notion of "objectivity" itself is under siege, as is dispassionate scholarship based on free inquiry. This issue was raised in 2016 by Jonathan Haidt, one of the founders of Heterodox Academy, who said universities would soon have to choose between pursuing either truth or social justice as a "telos."[18]

"Critical" race, gender, and sexuality studies focus on alleged collective victimization, grievances, and oppression. Scholars in these fields are less interested in individual agency than in the plight of marginalized groups. The very notion of scholarly objectivity itself is criticized for its tacit acceptance of historical oppression, and even for its use as a tool of oppression of marginalized groups in the guise of neutrality. In these fields, the market economy is usually described as an exploitative system that creates victims, rather than as a system that empowers individuals.[19] Any pushback against these claims tends to be criticized as a lack of sensitivity to historically marginalized groups, if not an outright defense of "white supremacy" or "the patriarchy." We thus confront serious epistemological problems.

[16] For a detailed analysis of the problems in women's studies, see: Patai, Daphne and Noretta Koertge. [1995]. *Professing Feminism: Cautionary Tales from Inside The Strange World Of Women's Studies*.
[17] Rickets, Glenn, Peter Wood et al. 2011 *The Vanishing West: 1964-2010, the Disappearance of Western Civilization from the American Undergraduate Curriculum.* National Association of Scholars.
[18] Miltimore, Jonathan. *Intellectual Takeout.* < https://www.intellectualtakeout.org/article/social-justice-fake-scholarship-oxford-philosopher-says>
[19] Roger Scruton analyzes the views of several critics of the market economy in Scruton, Roger. 2017. *Fools, Frauds and Firebrands: Thinkers of the New Left.*

In 2019, a self-described liberal professor at Yale University, speaking on condition of anonymity, told the *Wall Street Journal* that "universities are moving away from the search for truth" in favor of a search for "social justice."[20] Certain colleagues "think people who agree with them are smarter than people who disagree with them." This brings me to the professors.

3) The professors

Because university communities generally tilt to the left, the ideas of professors are sometimes reflected in the ideas of students. It is difficult to distinguish between correlation and causation: do stridently ideological professors shape the thinking of their students, or do they reinforce the views of students who were already tending towards a particular ideology?

Even measuring professors' own political views, although more straightforward, is not entirely without complications. One can carry out representative surveys among academics, in the hope that the respondents will answer honestly; another way to gauge political views is to analyze the party affiliation of faculty members. Neither approach is perfect, but both shed some light on broad ideological orientations:

- In the U.S., at Tier-1 universities, if one excludes the two military colleges (West Point and Annapolis), there are 21.5 Democratic tenured faculty members for every Republican Faculty member.[21] The imbalance is less severe, but still highly pronounced, at less selective schools. At Tier-2 colleges, for example, the ratio is 12.8 to 1. [22]

- Research by Sam Abrams regarding general views of faculty members (rather than Party affiliation) indicates that "faculty members [at American universities] … have a ratio of [liberal to conservative of] about six to one, with 13 per cent of our nation's professors identifying as conservative."[23]

[20] https://www.wsj.com/articles/yale-prof-estimates-faculty-political-diversity-at-0-11575926185
[21] Langbert, Mitchell. 2018. "Homogeneous: the political affiliations of elite liberal arts college faculty." *Academic Questions.* https://www.nas.org/academic-questions/31/2/homogenous_the_political_affiliations_of_elite_liberal_arts_college_faculty [Reference to Mitchell Langbert, Brooklyn College,
[22] https://www.nas.org/academic-questions/31/2/homogenous_the_political_affiliations_of_elite_liberal_arts_college_faculty [Reference to Mitchell Langbert, Brooklyn College,
[23] https://www.insidehighered.com/views/2018/11/08/college-administrators-are-more-liberal-other-groups-including-faculty-members
Abrams was denounced by progressive activists at Sarah Lawrence college, who called him "an anti-queer, misogynist, and racist who actively targets queer people, women, and people of color".[23] Abrams has stated he has received a significant number of private messages of support by academics who support his freedom of expression, but that these supporters are fearful of publicly supporting him. See: "Demands." The Diaspora Coalition at Sarah Lawrence College. 2019. http://www.sarahlawrencephoenix.com/campus/2019/3/11/demands-westlands-sit-in-50-years-of-shame

- Among college administrators, there is “a liberal-to-conservative ratio of 12 to one,” far more imbalanced than Professors themselves.[24]

As key decisions are increasingly made by an administrative class, and less by departments and faculty members, academic institutions tilt ever further to the left.

The growing risk of using “diversity statements” as political tests

The growing fashion for mandatory “diversity statements” at some universities, notably in the University of California system, merits special attention. Increasingly, individuals who apply for academic positions must score high marks on their diversity statements. The aim of such statements appears to be to foster more hiring of individuals who adhere to the ideology of social justice.

Here is one example. The University of California-Berkeley’s scoring rubric warns that, if a candidate were to state in his diversity statement that “the field of History definitely needs more women”—which a layman might see as indicating a commitment to diversity—such a statement should *not* be scored favorably by the evaluator. The rubric considers such a statement to be an indication that the candidate is guilty of having “little demonstrated understanding of demographic data.”

What is not wanted in these statements is a different view on, say, what constitutes “social justice,” or a defense of pure meritocratic ability, or indeed, a value judgment that ranks individual ability above collective identity.[25]

In addition to UC-Berkeley, Vassar, Vanderbilt, and the University of Pennsylvania also provide guidance on how to write such diversity statements. Peter Boghossian, a professor at Portland State University, said such universities are simply “looking for an ideological sieve to weed out people who don’t comport with the reigning moral orthodoxy.”[26] In December 2019, the acclaimed mathematician Abigail Thompson publicly raised concerns about the mandatory

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[24] “Indeed, through a new national survey of administrators in higher education that I conducted over the summer of 2018, which examined a nationally representative cross section of over 900 college administrators, I found that administrators are far more liberal than both the faculty members who teach our students in the classroom and the very students whom they indoctrinate. Two-thirds of administrators self-identify as liberal, with 40 percent of that liberal pool stating that they are far left. A quarter of them call themselves middle of the road, while only 5 percent say they are on the right. That makes for a liberal-to-conservative ratio of 12 to one.
Faculty members, in contrast, have a ratio of about six to one, with 13 percent of our nation’s professors identifying as conservative.”
Abrams, Samuel. 2018. “One of the most liberal groups in America.” <https://www.insidehighered.com/views/2018/11/08/college-administrators-are-more-liberal-other-groups-including-faculty-members>

[25] “Rubric to assess candidate contributions to diversity, equity, and inclusion.” University of California-Berkeley Office for Faculty Equity and Welfare. 2018. https://ofew.berkeley.edu/sites/default/files/rubric_to_assess_candidate_contributions_to_diversity_equity_and_inclusion.pdf

[26] Diamond, Max. 2018. “Pledging Allegiance to Diversity, and to the Tenure for which it stands.” <https://www.realclearinvestigations.com/articles/2018/10/18/i_pledge_allegiance_to_diversity_and_to_the_tenure_for_which_it_stands.html>

diversity statements at many University of California campuses being used as a *de facto* "political test." A professor at the University of California-Davis, Thompson wrote:

> The diversity "score" is becoming central in the hiring process. Hiring committees are being urged to *start* the review process by using officially provided rubrics to score the required diversity statements and to eliminate applicants who don't achieve a scoring cut-off.
>
> *Why is it a political test? Politics are a reflection of how you believe society should be organized. Classical liberals aspire to treat every person as a unique individual, not as a representative of their gender or their ethnic group.* The sample rubric dictates that in order to get a high diversity score, a candidate must have actively engaged in promoting different identity groups as part of their professional life. The candidate should demonstrate "clear knowledge of, experience with, and interest in dimensions of diversity that result from different identities" and describe "multiple activities in depth." *Requiring candidates to believe that people should be treated differently according to their identity is indeed a political test* … Mathematics must be open and welcoming to everyone, to those who have traditionally been excluded, and to those holding unpopular viewpoints. Imposing a political litmus test is not the way to achieve excellence in mathematics or in the university. Not in 1950, and not today. [emphases added][27]

Thompson's defense of classical liberal principles and individualism resulted in a storm of criticism from social justice advocates (including professors), which in turn resulted in a public letter defending her freedom of expression signed by others.[28] Earlier, in 2014, Professor Thompson had asked one of the most controversial questions in today's academy: Does diversity trump ability?[29] Even in a field as meritocratic as mathematics—open to all, based on symbols accessible to all those possessing some aptitude, with verifiable proofs—a radical understanding of social justice will increasingly clash with classical liberal principles and will require a vigorous counter-response.

Overall, then, the trends in American higher education are concerning. The places that ought to be the freest in our society are becoming some of the least open when it comes to discussing controversial topics.[30] Increasingly, even those liberal professors who pride themselves on being open-minded are coming under pressure from radical social justice activists.[31]

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[27] Thompson, Abigail. 2019. "A word from…" https://www.ams.org/journals/notices/201911/rnoti-p1778.pdf

[28] "Responses to 'A word from…Abigail Thompson.'" *Notices of the American Mathematical Society*. < https://www.ams.org/journals/notices/202001/rnoti-o1.pdf

[29] Thompson, Abigail. 2014. "Does diversity trump ability? An example of the misuse of mathematics in the social sciences." Volume 61, Number 9. P. 1024- 1030.

[30] Lukianoff, Greg and Jonathan Haidt. *The Coddling of the American mind: how good intentions and bad ideas are setting up a generation for failure*.
Campbell, Bradley and Jason Manning. *The rise of victimhood culture: Microaggressions, safe spaces, and the new culture wars*.

[31] Stanley-Becker, Isaac. 2015. *The Washington Post*. "Yale instructor at the center of racial protest to leave teaching role." < https://www.washingtonpost.com/news/grade-point/wp/2015/12/04/with-her-words-this-instructor-helped-set-off-protests-over-race-and-a-debate-over-free-speech-now-shes-leaving-yale/ >

In the UK, there are fewer surveys of faculty views, but the available evidence indicates a similar tilt to the left among higher education staff.[32]

4) The boards of trustees

In practice, universities are increasingly governed by administrators who share even more "progressive" political views than the professors who do the teaching.[33] Even so, boards of trustees, not administrators, wield ultimate authority, and these boards should reclaim some of the power they have ceded to administrators in order to implement necessary reforms. To the extent there are serious problems, boards of trustees are ultimately responsible for them.

For instance, boards of trustees themselves should strive to ensure that a variety of perspectives are represented in classroom, extending real support for different political views, to enforce genuine education instead of indoctrination.

Conclusion

What concerns me the most about trends on university campuses is not the prevalence of left-of-center views on campuses per se. Rather, I am concerned about the increasing control of "social justice" advocates over large sections of the mainstream left, as well as the increasing rigidity of some advocates of social justice with regard to salient political topics such as Israel, Islam, and clerical rule in Iran, among other issues.

If one tries to have an earnest debate on such issues, this can be difficult: disagreement can be rejected as immorality. There has been a marked decline in the willingness of some individuals on the left to view their political opponents on the right as moral agents with whom they have policy disagreements, as opposed to immoral persons who do not deserve to be heard, much less debated.

Serious problems arise when, in the institutions of education, instructors seek to impose certain preconceived ideas, instead of teaching students to think through concepts and approach them critically, including the positions favored by the instructors themselves. Real critical thought requires a willingness to re-examine one's fundamental assumptions. In order to teach students this fundamental lesson, genuine diversity—viewpoint diversity—is indispensable on university campuses. This lesson was learned the hard way on both sides of the Atlantic in the nineteenth and twentieth centuries, when it tended to be religious dogma that stood in the way of free inquiry. It will be ironic if, by allowing the secular doctrine of social justice to become the new and inflexible orthodoxy of our time, we have to relearn that same lesson.

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32 https://www.timeshighereducation.com/news/almost-half-of-sector-to-back-labour-the-election-poll-suggests/2019944.article [Caveat is that this survey was self-selecting]

33 https://www.insidehighered.com/views/2018/11/08/college-administrators-are-more-liberal-other-groups-including-faculty-members

AYAAN HIRSI ALI

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Ayaan Hirsi Ali is a research fellow at the Hoover Institution, Stanford University, and founder of the AHA Foundation. She served as a member of the Dutch Parliament from 2003 to 2006.

While in parliament, she focused on furthering the integration of non-Western immigrants into Dutch society and defending the rights of Muslim women. She has written several books, including *Infidel* (2007), *Nomad: From Islam to America, a Personal Journey through the Clash of Civilizations* (2010), *Heretic: Why Islam Needs a Reformation Now* (2015), and *The Challenge of Dawa* (2017).

Her next book, *Prey: Immigration, Islam, and the Erosion of Women's Rights*, will be published by HarperCollins in 2020. Prior to joining the Hoover Institution, she was a fellow at the Belfer Center's Future of Diplomacy Project at Harvard University and a resident fellow at the American Enterprise Institute in Washington, DC. She received her master's degree in political science from Leiden University in the Netherlands.

Taking Ideas to Action around the World

"Culture and the Free Society"

Samuel Gregg

Research Director

Acton Institute

Mont Pelerin Society Meeting

Hoover Institution

17 January 2020[1]

Thank you. I'm grateful to be here and to John Taylor for the kind invitation to speak on this important topic of how to translate the ideas of liberty into action throughout the world. My remarks are not going to be on the technical dimension of this topic. Rather, I'm going to focus on a broader strategic question, with particular reference to a topic I think needs more attention: That topic, as you can see, is culture.

I take it that one assumption underlying this panel's topic is that the free society is primarily a product of Western societies. By this, I mean that the roots of the free society are primarily—not exclusively—but primarily found in the philosophical, religious, political, legal and economic inheritances bequeathed by Jerusalem, Athens, Rome, the Jewish and Christian religions, and the various Enlightenments, not to mention numerous thinkers ranging from Aristotle to Aquinas, Smith, Burke, and Tocqueville. That is, I'd suggest, what the founders of our Mont Pelerin Society had in mind when they used expressions like, quote, "the central values of civilization" and, quote, "Western Man" in their 1947 Statement of Aims.

If that's true, the question becomes: how does one take ideas about freedom to societies where the dominant cultural settings are not well disposed to the free society? How do we spread these ideas in cultures where there is not, for instance, a strong history of rule of law, or where liberty has not been a dominant normative concern, or where political life has been dominated by top-down mentalities, or where civil society is weak to non-existent?

I spend some much time studying the relationship between culture, liberty, and the free economy. So let me offer some insights and suggestions based upon what I have learned.

My first insight is the sheer difficulty of such endeavors. Cultures are not easy to change. As we know, recent efforts to shift societies marked by tribalism and quite different philosophical and religious heritages to the West in the direction of more freedom have not turned out so well. Now I happen to believe that there is such a thing as human nature and a natural law knowable by all human beings because we all possess reason. But I also think that culture—by which I mean the dominant ideas, beliefs, value-commitments, attitudes, expectations, rules, and institutions that shape life in a given society—is very powerful.

My second insight is that the political left have always understood the importance of "winning the culture" if you want to shift societies in particular directions. Incidentally, this topic was discussed at length during the 1972 Mont Pelerin meeting in Switzerland. Those of you who know me will know that I don't often recommend Marxist thinkers, but I do think that the writings of the Italian Marxist, Antonio Gramsci are very important for us to read today. While most Marxists of his time stressed the economic means of production as the primary driver of history, Gramsci believed that capturing what he called the cultural means of production was more important. I don't think that it's an exaggeration to say that the left has been spectacularly successful in realizing that objective. And the consequences for free societies have been decidedly negative.

My third insight is that, thanks to particular economists and historians—I'm thinking specifically of Nobel economists Douglass North and Edmund Phelps and the economic historian Eric Jones—we have considerable evidence of how certain values embodied in particular cultural settings influence economic development. We know, for instance, that if a given culture constantly prioritizes equality-as-sameness over liberty and creativity, it is hard for a society to move towards greater freedom. That's one of the key lessons I took from Jones' 1981 book *The European Miracle* and Phelp's 2013 book *Mass Flourishing*.

Put another way, institutions, law and economic policy certainly matter. If policy changes don't happen, free societies won't grow. But if the ideas of a free society are not grafted into a culture, or accepted by some of those who shape culture, you have good reason to worry whether policy changes will last. Chile is a good example of this. Economic liberalization from the mid-1970s onwards delivered in terms of economic growth and the diminishment of poverty. But the riots and social upheaval which have plagued that country since late 2019 until now surely reflect in part the fact that large and influential segments of the population never accepted the normative case for economic liberty. Perhaps that case was never even put to them in the first place.

If all I have said is true, what are some practical ways to take the ideas of liberty into societies where they are not been noticeably strong? These suggestions are not listed in any order of importance, but I do think they matter.

My first suggestion: it is always worth trying to find traditions of liberty that exist in a given culture, even if it is not a lively tradition in the present. The reason for this is that, in my experience, many people in a given cultural setting are more willing to accept certain arguments if they believe such positions have been previously expressed in some way by individuals who were clearly part of that culture.

When, for example, I am speaking to Jewish audiences, especially religious Jewish audiences, whether in Israel or elsewhere, I'm careful to link my arguments to impeccably Jewish sources. Or if I'm in Latin America and addressing, for instance, a group of Catholic bishops, I make extensive references to scholastic thinkers, from Aquinas onwards, who made important contributions to economic thought that most of us take for granted today.

My second suggestion: it is important that the bulk of the work of persuasion is done by people who live in a given society or who have standing in a particular tradition. It is important that people come from "the outside" to spark debates about liberty. Milton Friedman, for instance, spent much time in the 70s and 80s visiting different countries, meeting politicians and policymakers, debating local leftists, etc. Sometimes it's easier for a foreigner to start the process of challenging collectivist status quos.

In the long-term, however, these ideas need to be expressed and developed from "within": by networks of intellectuals, business leaders, academics, journalists, and policymakers who live in these countries, or whose voices carry weight in their respective traditions.

One important task is thus to undertake the often tedious long-term work of helping these networks establish themselves and acquire their own momentum. The purpose is to put like-minded people in touch with each other, to develop focus to often uncoordinated efforts, and help them attain the resources they need to pursue their goals under their own volition.

But above it is to give a face, an accent, and an emphasis to our ideas that can't be dismissed by our opponents as an imposition from the outside by assorted Anglophones like myself. A good example of this is the Islam and Liberty Network, which has done excellent work in some difficult environments. In more recent years, some of my colleagues, most notably, Alejandro Chafuen, have been building up networks of free market, limited government-inclined Evangelicals and Catholics in Spanish-speaking and Portuguese-speaking Latin America.

My third suggestion: if you want to shift a given culture towards greater acceptance of markets and limited government, we need people who can speak beyond the world of economics. Many people come to the ideas of the free society through studying free market economics. I myself spend much time writing about political economy. But many people are more responsive when ideas for freedom are presented through a different lens. That's especially true at the level of culture. Putting ideas into action thus means working with individuals who can exercise considerable cultural influence: historians, novelists, scientists, religious leaders etc.

On the screen, you see two examples. As we all know, economic critiques of the New Deal have been around for a long time. These are important. But my suspicion is that far more people have embraced more critical views of the New Deal by reading the journalist and historian Amity Shlaes' 2007 book *The Forgotten Man*. This integrates history and narratives to explain why the New Deal was so damaging to freedom. Another example would be the theologian, the late Michael Novak. His 1982 book *The Spirit of Democratic Capitalism* was highly influential in shifting religious Jews and practicing Christians in countries ranging from Chile to Poland towards more favorable views of the free economy. Yet the core of Novak's argument wasn't economic: it was philosophical, theological and historical.

I could go on and say more, but I'll summarize by saying this. If we want the ideas of the free society to flourish in environments not presently inclined in that direction, we must take culture deadly seriously. That means pursuing a delicate combination of approaches: of challenging some existing norms, but building on others; of challenging some dominant narratives in a given tradition while developing other narratives grounded on other aspects of that same tradition. But above all, we must recognize that there are no shortcuts if you want lasting change. There are no magic bullets. Policy matters. Politics matter. Embracing the habits, practices, and institutions of economic liberty are especially important. If you are successful, however, in grafting ideas of freedom into the culture of these societies, there is every reason to expect essential transformation to occur and every reason to expect such change to last. Winning the economic argument is indispensable. But if you can win the culture as well, I think that you stand to win everything.

SAMUEL GREGG

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Samuel Gregg is research director at the Acton Institute and a fellow at the Center for Law and Religion at Emory University. He has a PhD in moral philosophy and political economy from Oxford University, and writes and speaks extensively on political economy, finance, economic history, and natural law theory.

Gregg oversees domestic and international academic programming, conferences, and seminars at the Acton Institute. He is also the current president of the Philadelphia Society. His articles have been published in journals including the *Harvard Journal of Law and Public Policy*; the *Notre Dame Journal of Law, Ethics and Public Policy*; the *Journal of Markets and Morality*; *Economic Affairs*; and the *Journal of Scottish Philosophy*. He has also written for newspapers and other print and online publications, including *Foreign Affairs*; *First Things*; the *National Review*; *American Banker*; *Law and Liberty*; *Real Clear Politics*; *Real Clear Markets*; *Wall Street Journal Europe*; *Investor's Business Daily*; the *Washington Times*; the *Australian Financial Review*; *El Mercurio*, and the *Jerusalem Post*. Gregg has written fifteen academic and popular books, most recently *Reason, Faith, and the Struggle for Western Civilization*.

Taking Ideas to Action Around the World
Mont Pelerin Society – Stanford, CA
January 17, 2020

Bridgett Wagner – Vice President, The Heritage Foundation

I try to close out each year going through files of saved op-eds and speeches that I find inspiring. It's a great way to pull back from the day-to-day skirmishes and put our long war of ideas into the broader context. It's always surprising how relevant I find some of these clippings.

One piece I return to over and over is Jim Buchanan's "Saving the Soul of Classical Liberalism," a *Wall Street Journal* column published on January 1, 2000. I encourage you to read the whole column. It provides great advice for today, but in the context of this morning's session, I was particularly struck with this section:

> *The 1950's were dark days for classical liberals. Big Government was an idea tolerated across the political spectrum in Western nations. In those years my colleague Warren Nutter often used to say that 'saving the books' was the minimal objective of classical liberals. At the very least we had to keep liberal ideas in print. Friedrich von Hayek, the free market's great advocate, broadened Nutter's notion to 'saving the ideas.'*
>
> James Buchanan, "Saving the Soul of Classical Liberalism,"
> *The Wall Street Journal*, January 1, 2000

In the age of internet access and information overload, it's difficult to imagine a call to "save the books" or "save the ideas" was made within the lifetime of this society – indeed, within the lifetime of many at this meeting. With online access to academic journals and original sources, it is hard to impress on young people today just how precious books and texts you can hold can be.

I was reminded of this earlier this week in reading through the obituaries of Sir Roger Scruton. One of the many contributions he made during his lifetime was his support for dissident academics in communist Eastern Europe. He helped to support an underground education network by smuggling in books, organizing lectures and courses, and forging links between these academics and their counterparts in the West. Journalist and historian Anne Applebaum tweeted out Scruton's obituary and noted she was one of his student couriers. It was a good reminder that saving the ideas sometimes requires *physical* action.

Today, our fellow MPS member Linda Whetstone has taken up this task through the Network for a Free Society. The network's vision is of a world of opportunity and prosperity based on the foundations of a free society – individual freedom, limited government, the rule of law, the protection of private property, free markets and free speech. By making "the texts and ideas which explore and explain these values accessible in countries and in languages where they are currently not available" they are increasing the number of people who share these ideas and the commitment to liberty. And in turn, they will become the intellectuals who change the climate of opinion in favor of freedom.

Linda has shared thousands of copies of books and hundreds of thousands of CDs. It's possible to pack dozens of texts onto a little round disc and ship these to local partners to be shared with students and professors in hard-to-reach corners of the globe. Afghanistan, Iran, Tajikistan, Burundi, and the Democratic Republic of Congo are just some of the places you'll find these CD's in use. They spark debates, conferences, trainings and essay competitions; and they help to build an understanding of the role of markets, property rights and the rule of law in creating wealth and improving lives.

As Max Hartwell described in the history of the Mont Pelerin Society*:*

> The great intellectual entrepreneurs like Hayek initiate intellectual change and are 'the vital few' in the great battle for ideas, but the impetus to significant changes in the tide of human ideas comes from the many followers who accept the new ideas and circulate them in the academies, in the media, and in the public.[1]

Today there is a vast ecosystem of followers, the second-hand dealers of ideas. Bob Chitester showed us the impact that documentaries can have when he put Milton Friedman in front of a camera. "Free to Choose" educated millions on the basics of market economics, and in the process, prepared the ground for the Reagan Revolution. Russ Roberts' popular Hayek-Keynes "Fight of the Century" rap videos were a novel translation targeted to a younger generation. College students and teenagers across the country memorized the lyrics and impressed parents everywhere from the back seat in the carpool.

Short videos are reaching a wide audience through the classroom, as in the case of Izzit --or in some cases they go around the classroom, like PragerU. Last year, in one year alone, PragerU had more than one billion views. And, full-length films produced by organizations like Free to Choose Media, Moving Picture Institute or the Acton Institute tell stories and connect emotionally with audiences.

Podcasts, online universities, videos, memes and Twitter debates are today's tools of engagement. Think tanks devote enormous energy to media outreach and marketing strategies because they understand how important this is in terms of shaping the climate of opinion or changing the contours of the battlefield in the war of ideas.

This morning's panels point us toward action and ask us to share some examples of how we might successfully move ideas *into action* around the world. I will outline a framework and give you an example of an issue put through this framework. And I'll share a few practical recommendations from our friends who are in the business of capturing case studies and growing the network.

[1] R.M. Hartwell, *A History of the Mont Pelerin Society,* Liberty Fund Inc., 1995, p. 228.

Changing the Battlefield

In his 1997 Mont Pelerin Society Presidential Address, Ed Feulner noted:

> …it's possible for we liberals to win the war of ideas but nonetheless fail to change the world. Ideas are decisive, but not self-implementing…[it] is not an automatic, straight-forward process. In fact, as public choice theory points out, it is made more difficult by the democratic forces freedom-loving peoples fight to preserve.
>
> How, then, do we translate our ideas into laws that not only block the road to serfdom, but also clear a path to freedom? Today, this has become a key question….how do we return power to the individual?...How do we change the current "calculus of consent"?

Many of you may be familiar with the concept of the "Overton Window" named for the late think tank leader, Joseph Overton. Joe helped lead the Mackinac Center for Public Policy in Michigan. He also helped to train dozens of think tank leaders and championed school choice.

Joe was tireless in his advocacy for school choice, but he also understood that books, white papers and op-eds alone would not win this battle. After all, Milton Friedman first wrote about school choice in 1955 in his essay, "The Role of Government in Education"[2] and again in *Capitalism and Freedom* in 1962.[3]

There is a powerful public school establishment preventing the state's "education Berlin Wall," as Joe called it, from coming down. Unions fight to protect their powerbase and school superintendents fight to maintain their enrollment and funding. This is typical behavior for a subsidized, unaccountable monopoly, as Joe saw it. They treat their clients as hostages, not customers.

Politicians fear the unions and their political war chest. And parents are not as well-organized, particularly low-income parents. Lost in the middle of all this are the students, the hostages.

Joe was a think tank leader, but he was also trained as an engineer so, he analyzed the problem and came up with a solution that drew from Hayek's advice to Antony Fisher.

The story is told and known by many in this society: Following World War II, Sir Antony had an opportunity to meet Professor Hayek at the LSE and seek his advice on how to get the country on the right track. Fisher had read *The Road to Serfdom*, and he thought politics might be the route. Hayek told him not to waste his time. It's the intellectuals who are decisive in the battle of ideas, according to Hayek. They are the ones who shape the contours of the battlefield.

As Joe worked it out, politicians have to operate within the limits of what is acceptable to public opinion, a political safe space or a window. Operate outside the window and you risk losing popular support and maybe even your political office. But this window can be shifted or even

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[2] Milton Friedman. *The Role of Government in Education.* New Brunswick, Rutgers University Press, 1955. Print.
[3] Milton and Rose Friedman, *Capitalism and Freedom.* Chicago: University of Chicago Press, 1962. Print

expanded by changing the climate of public opinion. And once it has shifted, it can become popular (or even necessary) for a politician to support a position.

How do you shift the window? Most often this is the work of the intellectuals and popularizers, the think tanks and policy entrepreneurs, the activists and investors, the writers and those operating in the culture.

Let me use school choice as an example of shifting the Overton Window to advance a policy idea because it draws on so many of the tools we can use: experts and their research, transparency and accountability, publicity and story-telling, coalition-building, moral authority, and networks that share success and learn from each other.

I should apologize in advance to the education experts like Hoover's own Bill Evers who might be in the room. This will be *very* abbreviated. My intent is not to outline the history of school choice, but to share some of the milestones along the way that allowed the Overton Window to shift, and allowed the politicians to take the next step in moving toward Milton Friedman's vision.

It Starts with an Idea

So, let's start with Milton Friedman. Not only was he one of the vital few generating the ideas, as Bob Chitester pointed out, he was also a popularizer. Episode 6 of the 1980 PBS series, "Free to Choose" focused on "What's Wrong with our Schools?" He starts with the dangerous and failing schools, contrasts them with what's working, zeroes in on parental control as being the key, examines choice experiments, explains how the marketplace works in higher education, and has a very animated series of conversations with the experts -- including the head of the teachers union – during the discussion portion of the video. All this is beautifully filmed, distilled, and distributed to millions of households in must-watch television. Friedman prepared the battlefield for education reforms to come.

We know that Ronald Reagan was influenced by Friedman. He even filmed a short video praising "Free to Choose" and described it to the viewer as "a survival kit for you, for our nation, and for freedom."

Reagan's first Secretary of Education Terrell Bell came into office with a mandate for reform. He established a National Commission on Excellence in Education that issued a blistering report in 1983 titled, "A Nation at Risk."[4] The report dominated news and launched a nation-wide conversation about the state of our schools and how we should reform them. The conversation took place on both sides of the aisle and drew in local officials, business leaders, and teachers because the commission itself had included local officials, business leaders and teachers. A discussion of reform was not just possible, it was necessary. The first wave of reforms focused on content and testing, but reformers didn't stop there. The window was shifting.

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[4] United States. National Commission on Excellence in Education. *A Nation at Risk: the Imperative for Education Reform: a Report to the Nation and the Secretary of Education.* Washington, D.C.: The Commission: [Supt. Of Docs., U.S. GPO. Distributor], 1983. Print.

Scholars began researching delivery of education, competition, and choice. We saw experiments with schools within schools, and the head of the American Federation of Teachers even came out in support of charter schools in 1988. Businesses and philanthropists stepped in to provide choice scholarships, and this helped to demonstrate demand on the part of low-income parents of children in failing schools. This shifted the window of opinion further.

Parents began to look for the best schools for their child and that required information. You began to see *some* schools treat parents and students as clients and not hostages. And, when demand outstripped the supply of private scholarships, parents began to organize for political change.

In 1990, Milwaukee established the first school choice program in the United States. And, in a way, confirming just how far the debate had shifted, the bill was championed in the state house by a Democratic politician – an African American woman who represented Milwaukee – and the Democratic mayor of Milwaukee. And then in 1991 the Wisconsin Supreme Court upheld the constitutionality of the Milwaukee program overcoming legal challenges brought by the state superintendent and the unions.

Today the number of education options is expanding. Not fast enough so, some of us are working on how to address the opposition, namely the unions, with legislation, litigation, and education to expand worker freedom. Teachers and all public employees should be able to choose whether union membership is right for them. And, when given the choice, many have opted to leave their union and stop paying dues, thanks to important Supreme Court litigation, ongoing state litigation, and very active public awareness campaigns led by allies in the states, like the Freedom Foundation, the Mackinac Center, and the Buckeye Institute, which is represented at this conference.

Exposing the opposition and denying them support – both the financial and moral support that they have taken for granted – will have an enormous impact on the freedom agenda.

The Overton Window is a theory of social change that is built on incremental victories. We may want every family to have the ability to access the education that best meets the needs of their child. But to get there we need politicians to take action, and they will only go as far as they think public opinion will allow them to and stay in office. We can change the politicians – and we have seen that work, but we don't always have a Ronald Reagan or Margaret Thatcher waiting in the wings. We can change the climate of opinion, and that paves the way for the good politicians. It also helps move the others to take good actions in the meantime.

Opportunities and Challenges

Today we are seeing the incremental approach, shifting the Overton Window, play out in a number of policy areas. Occupational licensing reform, for example—start with the hair braiders and interior designers and then move on to teachers and doctors. Today, we see states like Arizona passing universal licensing recognition laws. If you have a license in good-standing in one state and you move to Arizona and your current license meets their requirements, there's no need to start all over.

Or health care reform: Allow for health savings accounts, reform your tort liability system, allow for direct primary care, reform certificate of need laws, and you'll start seeing innovation around the traditional models of health care provision. Today, we have CVS "Minute Clinics" and WalMart is experimenting with Health Care Centers in underserved communities with high patient-to-doctor ratios. Patients might get used to being treated as customers. Just imagine, they might start asking about prices. This could create a market place!

We have many challenges in moving ideas into action at the national government level, and not just in the United States. As David Henderson stated in his paper, politicians hear mainly from the beneficiaries of government policies. Well-organized interests are well-represented in their nations' capitals. But in our competitive federalist system here in the United States, policy innovation can occur in the states and local communities. And the ecosystem of think tanks, experts, litigators and activists in the states is strong and growing.

The Heritage Foundation's *Index of Economic Freedom*, the Fraser Institute's *Economic Freedom of the World* index and the World Bank's *Doing Business* report have helped promote economic freedom around the world. There are also indexes that rank states, and the Lithuanian Free Market Institute has a municipal performance index. Atlas Network and the Fraser Institute provide support for economic freedom audits to their more than 450 think tank partners.

These indexes spur competition and help reformers drive change from within their countries. Embassies regularly contact the Heritage Index team to make sure they have taken notice of the latest reforms that might impact the scores. I'm told on the state level, Index authors get the same calls from governors' offices.

They also spur calls to ask *how* they can raise their rankings, and at that point we can say that the Overton Window has shifted. They are ready to talk about reform. Interestingly, each year we see that the most popular portion of the Heritage.org website is our *Index of Economic Freedom* –more than 7.7 million page views in 2019. In presentations to international visitors we point out that the indexes can be used to develop an agenda for reform. Next month, Heritage will release our 2020 Index and a companion volume that will map a reform agenda to move the U.S. to the #1 position in the rankings.

Conclusion

Books, indexes, videos, podcasts, and social media are all great tools, but what if we are not allowed to *express* our ideas? Will they really be saved, as Hayek called on us to do? Ayaan Hirsi Ali has addressed this with regard to higher education in her paper.

Perhaps the greatest challenge we face is the attack on free speech, and this requires action on our part. Let me return to Sir Roger Scruton. Some of you may remember that less than a year ago, a journalist for the *New Statesman* crafted a hit piece which misrepresented his views on a number of issues. The journalist selectively edited and rewrote quotes so as to portray him as a racist. Demands were made for the British government to remove him from an unpaid advisory commission. The government took the bait and sacked Sir Roger.

Eventually, he was vindicated and reinstated, but everyone got the message: Challenge the orthodoxy and you will be dealt with. *And* when it comes to the left, the ends justify the means.

Unfortunately, this episode is repeated much too often with academics and authors on the right -- accusation, twitter mob, media pile on, loss of job, and social ostracism. What are we to do? Retreat is not an option in this battle.

Niall Ferguson looked to the Cold War for lessons in a column in the *Boston Globe* last April:

> A direct descendant of the illiberal, egalitarian ideology that once suppressed free speech in Eastern Europe is now shutting down debate in the West…. But the lesson of the Cold War is clear. From now on, an attack on one of us must be considered an attack on all of us.[5]

We must hang together or surely we will hang separately.

At the very end of the history of the society, Max Hartwell provided a discussion of "Assessments and Conclusions." He measured the work of the society against the founders' aims and noted the members' contributions to the revival of liberalism. In summing up, Hartwell asked, "…was not the Society's role in supporting the individual liberal in the hostile intellectual world of the post-1945 era a sufficient justification for [our] existence?"[6]

I would say this continues to be the most important action we can take today.

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[5] Niall Ferguson,"A message to all professional thinkers – we either hang together or hand separately," *Boston Globe*, April 15, 2019.
[6] *A History of The Mont Pelerin Society,* p. 231.

BRIDGETT WAGNER
HERITAGE FOUNDATION

Bridgett Wagner, as vice president for policy promotion at the Washington, DC–based think tank the Heritage Foundation, oversees its coalition relations, Truluck Center for Leadership Development, and Young Leaders Program, among other duties. All of these areas are focused on spreading conservative principles, policies, and ideas among allies, public audiences, interns, young professionals, and new audiences.

Wagner's responsibilities also include advising and consulting with fellow leaders in the think-tank and nonprofit communities. She first joined Heritage in 1981 as a research assistant to the president of the foundation, and she has served in various leadership roles in external relations, events, and fundraising.

Outside of Heritage, Wagner serves as a trustee at the University of Dallas and at the Intercollegiate Studies Institute. She is a director of the State Policy Network, the Foundation for Government Accountability, and the Fund for American Studies. She also serves on the Clare Boothe Luce Selection Committee of the Henry Luce Foundation.

Introduction on "What Happened in Chile?"

For a very long time, many have been talking about the amazing economic performance in Chile following the economic reforms. In recent months, however, there has been a big change—a reversal. And people are asking, what happened, why, and what can be done? These questions are paramount to the "taking ideas into action" theme of this Mont Pelerin Society meeting.

These questions and others are addressed in this session by Axel Kaiser, Executive Director of the Foundation for Progress in Chile; Ernesto Silva, Former President of the Independent Democratic Union Party in Chile; and Arnold Harberger, professor at Chicago and UCLA, one of the famous Chicago Boys, affectionately called Alito, who helped bring reforms to Chile.

Presentation on “What Happened in Chile?”

Axel Kaiser

I have to go a little bit into my background, because a lot of you don’t know this. I predicted this would happen. Ten years ago, 2009, I published a book that was called The Fatal Ignorance. I said that if Hayek claimed that the socialist problem was arrogance, well, the center right problem – the center right at least in Chile –was is ignorance. And I predicted in very great detail that at some point we would have a government that would try to destroy the free market system that we had inherited from the Chicago boys, and the only thing I had to do for predicting that was to read what the left was saying at the time.

So, I became sort of the face of the Chicago School in Chile. I have been engaging with all the major leftwing intellectuals, also politicians, at universities, on television, and so on and so forth. As a result, I have a percentage of people who don’t like me very much.

But we managed to create a movement, we started six years ago what is arguably the most the most influential free market think tank in the whole of Latin America, because some businesspeople were willing to support it.

I thought this would be interesting for you to know. I have been threatened which is why I have been away from Chile for a while. And I think no one, even Alito, if he would come down to Chile right now, it would be a risk for you. So be careful.

So what happened? Chile is a clear case where narrative and storytelling destroyed reality. I’ve been arguing with my friends the Chicago boys about this, and the problem with the Chicago boys is that they didn’t leave a legacy. I mean by that, they did not have disciples who kept on the fight defending the ideas of freedom. There is nothing between my generation and the generation of Sergio de Castro, José Piñera, and all these people. Nothing. Thirty years without doing the advocacy. Well, there were some public policy debates, of course. But not saving the soul of classical liberalism like many people were saying in the previous session.

So let me tell you three events that marked the end of the Chilean economic miracle, because I think it’s the end. I’m very pessimistic. And remember, I wrote two books predicting this would happen. I’m not saying this because I’m bragging about it, but I don’t want to be the general after the battle.

First of all, the election of Ricardo Lagos, the first socialist president who came to La Moneda after Salvador Allende. Why was this so important, even though he did not make socialist reforms? Because he reintroduced into the public debate the concept of inequality. His slogan when he ran as a president was “growth with equality”. He said okay, we have brought down poverty but the really important issue is inequality, income inequality. And when he was elected, the University of Chile, the most emblematic institution in the nation, along with the Chilean Ministry of Planification, issued a report saying that this was the opportunity to get rid of the neoliberal system. This was in the year 2000. They were already speaking about this.

In 2005 one of the most emblematic businessmen in the country, who owned Revista Capital, which is like a Forbes magazine in Chile, organized for the first time a seminar for the whole of the business community and the political community with the title “Inequality of Opportunity: Chile’s Greatest Shame”. And on these panels, everyone agreed that the problem in Chile – we were not a developed country, we are still not a developed country – was inequality. And from then on, the debate started, also among business elites, to be about inequality. They felt very guilty, because they had made a lot of money, and it looked like they didn’t really understand that they lifted up a lot of people from poverty because they had made a lot of money. So, they started saying, “Yes, we have to admit we have a problem. We owe society, because we have so much, and the others don’t have so much.” That was the majoritarian position among the business elite – I wouldn’t say everyone, because that wouldn’t be fair.

And then the third event. Five of the leading nation’s intellectuals, all trained in the United States and the UK wrote a book called The Other Model, El Otro Modelo. Meaning, we have to get rid of the neoliberal model, in order to introduce sort of a welfare state collectivist model. On the cover, you saw five workers destroying a brick. Now “the brick” was the name given to the book that the Chicago boys wrote in order to make the reforms in Chile. And who presented “The Other Model” in 2013? Michelle Bachelet, who later, the year after that, became the president of Chile, saying that we had to make dramatic changes to the neoliberal system, because it was so unfair. The facts didn’t matter. This is not about facts. It’s about storytelling and narrative. And what did she do? Exactly that. She won a majority in the parliament, and she made a massive tax reform, labor reform, educational reform. Public spending went up through the roof. Public debt increased, and so on and so forth. As a result of that, we had stagnation. Average GDP growth fell from 5.3% under the previous administration to less than 2% under her administration. And for the first time since the 1960s, we had four consecutive years of collapsing private investment in the country.

Now Piñera came back to government and said, “We are going to bring back better times.” That was his campaign slogan: better times. He miserably failed. Why? Because he lacked the conviction. It is true that he didn’t have a majority in the parliament but he lacked the conviction to use his political capital. He won by more than 10 percentage points difference over the socialist candidate. And he didn’t use it to push for reforms. Something similar to what happened to Macri in Argentina.

Now let me go to the bottom of this, because I’m getting close to the finish here. In Chile what happened was that the economists and policymakers, the public policy experts, lost the debate to the lawyers and the philosophers. That’s what happened. And I’m amazed by my friends who studied economics at universities in the US, how little they know about philosophy and political philosophy, and about how important the fight for a sense of fairness is in order to win this debate. And the intellectuals on the left were working on the sense of fairness of the population. They were basically saying, “Inequality is the big issue. We have a lot of abuse. We have to get rid of the system if we want a society that’s more fair.”

I would caution you with something. I disagree with Condoleezza Rice. She said the other day, “It’s about equality of opportunity.” No. It’s not about equality of opportunity. Because I never met a socialist in Chile or anywhere else in Latin America – I've been debating this all over Latin America and Spain – who told me, "We want equality of result." Never. What they say is, "We want equality of opportunity." What they mean by that is that no one can get a better education – or healthcare, pensions, etc.,- than anyone else. And that was the argument Bachelet used in order to put an end to the voucher system in Chile. Because you had a copayment, so parents who had higher income could pay more for the education of their children, and that created inequality of opportunity. If you have inequality of results, you will have inequality of opportunities. That's why I like to speak about improving opportunities for everyone. It doesn't matter what's the difference in between the opportunities, in between people in general.

And so, what we are facing now in my opinion is a dramatic shift that started to take place 20 years ago in the political economy of the country. We are going to seriously damage the economic system. There is no question in my mind. If you take a look at the measures that were recently announced by President Piñera, especially regarding the pension system, this is going to be very harmful. Now we are going back to a pay-as-you-go system partially. And this will only be the beginning.

So, in 20 years – I close with this – unless something happens and we really engage in the battle of ideas that… we arrive too late, unfortunately, Chile will be much closer to Argentina, not Venezuela, because our armed forces are not Marxists. I don't believe that. But Chile will resemble more Argentina than what it used to be, a role model for the developing world. I'm already reading Norman Klein and other people saying, "See? Neoliberalism doesn't work. See? Hayek and Friedman were wrong. The poster boy, Chile, failed." So, we can't go down that path. I believe that Chile is the epicenter in this worldwide ideological battle. It's strange that such a small and irrelevant country became somehow so important in this struggle for freedom. And I believe that if we don't manage to get the message across, the whole classical liberal cause – I don't like the term neoliberalism, but we can debate that another time –will be discredited. The story will be "the people rebelled against the technicians" because the people didn't want this abusive system. So, with that, I'll be happy to take some questions, and I also wanted to thank Hoover for having me this time that I'm not very welcome in my own country.

Presentation on "What Happened in Chile?"

Ernesto Silva

I first want to share a personal note. I am proud of my country. I am also proud of what a generation of leaders leading my country. My father, he passed away nine years ago. He was one of the Chicago boys. He was a student of Alito and many others. And so I think that I feel proud of what we have been doing, and we need to keep fighting. That's at least my attitude for the future. Axel provided a great perspective on the battle of ideas, or maybe the lack of battle of ideas. And I just want to provide some information for the conversation of this discussion.

And I think the question here is this going to be a bump in our path towards development, or do we risk losing what we've been doing in the past? And the answer is not clear now. I will make five points.

The first, the context. Chile has been doing great in any measure that you want to take. As Axel mentioned, even in income inequality, we have been reducing inequality. We have been increasing wealth opportunities. Everything has been doing great. That generated a new middle class, and that new middle class is posing new challenges in terms of the democratic process, in terms of how to promote free market policies, how to engage in the conversation. And one of my points is that we have not been well prepared for that discussion.

Second, the facts. What happened in October? There was an increase of less than five cents in the metro fare in mid-October. Less than five cents. And so civil disobedience started when some people decided not to pay the metro fare. It started that way. And the night of October 18, more than a dozen metro stations were attacked simultaneously. They were burned, on fire. That was a criminal or terrorist attack. Organized. It was impossible that it was something not organized. But we still don't know who did that. After that, the reaction of a group of the population was to support violence as a way of promoting change. And that's really bad for the country. And that's really bad. A week after that, 1.2 million people went to the street to protest in Santiago, and 800,000 in the rest of the country. As you can imagine, different requests were on the street, some people asking for pension reforms, healthcare, so there was no one demand – different demands. But the left was very effective in trying to politicize that movement towards some ideas.

So, they were able to organize, in my view, those ideas into four issues. Number one: social issues such as pension reform, healthcare, minimum income. Number two: a new constitution, and I will go to that later. Number three: to fight against human rights abuses by the police and the military. They were trying to keep the city in order. But there was an organization to denounce violations of human rights. And finally, number four: the idea – and you mentioned this Axel – four, the idea of abuse. Business and government are abusing. We need to change the model.

Point number three: my explanation to what happened? I don't have a very good explanation, and we have been talking about this during the week, but some ideas. Number one: a problem of expectation for the middle class. The economy, as Axel mentioned, has been growing less in the last period – five years or six years – than expected, and the citizens expected more income for their families in order to move forward. So that gap of expectations, I think, had an impact. Number two: the lack of defense – and I won't go into more details, because Axel spent time on that today – the lack of defense and promotion of free market ideas. I would say that elites feel guilty for what they have been doing in Chile, and it should be the opposite. They should not feel proud, but they should keep looking for new opportunities of change, freedom, and improvement. Third: the agenda of Michelle Bachelet in her second government – taxes, constitution, and fighting inequality. Number four: I think that there was a change in the political system in 2000… I don't remember… fifteen? But it started working in 2017. We have a presidential system, and we have a congress with two chambers: the House and the Senate. And we used to have a system to elect a member of Congress for the House in 60 districts, two seats per district. That generated an environment of negotiation and moderated coalitions. But we changed that for the election of 2017 towards a proportional system. So, that was a mistake. I didn't mention this, but my background, I spent a year here at Hoover, but I was trained as a political scientist, but my life was in politics. I spent a decade in Congress and as president of my political party, which used to be the party closest to the Chicago boys. And we voted against, but we lost. And I think that generated a fragmentation in the political system that we're suffering now. Five – and not many people are talking about this: government failure. In a middle-income country, the role of government today, you like it or not, in providing healthcare, education, transportation, and security in neighborhoods, it's really important. And our government is not delivering as it should. So, it's more a crisis of the government than from markets, in my view.

And I think maybe, being critical with myself, I think we didn't promote or keep promoting new changes to foster markets, competition and ideas as we should. Maybe we thought that the job was already completed. And I think that's a challenge now – how to move forward.

And two special concerns that I want to share. The same happens in the US, but there is a huge generational gap in terms of how young generations think about free market ideas and also what they think about violence. More than 50% of the people between 18 and 30 are supporting violence as a way to promote change. And I will just stay in that concern.

So, where are we now? This is point number four. First, we are rewriting the constitution. The constitution has 39 years. It was written during the military government, approved by a referendum. Then, 40 great reforms changed that constitution in more than 200 amendments. So, it has been evolving over time, and improving, I think. But it was written during the Pinochet government, and they decided to fight against that in terms of origin. And second, the left feels that the current constitution limits the role of the government, and I'm happy it is, and they want to change that. So, there was an agreement the night of November 15th, to rewrite the constitution, and Chile will face a critical date on April 26th, because on that day is going to take place a referendum where the population will say if they want or not a new constitution. The polls three days ago were 80% in favor of rewriting the constitution, in a blank slate. We need to change that, and we have only 100 days. Then we will have a constitutional convention. It can be 100% elected or 50% elected and 50% members from Congress, it depends on the vote on the ballot in April. And we will have the election of the members of the convention in October. Just for the Mont Pelerin Society to think about this, imagine the campaign of the candidates for the convention. I want free higher education. I want healthcare. No one's going to say, or it's going to be difficult to say, "I want a limited government. I want to promote free initiative of individuals." It's going to be challenging. We are facing a very challenging year. And then, there's going to be one year of writing the constitution.

So, there's also a package of reforms in the [inaudible], including pension reform, as you mentioned before, a healthcare reform, a minimum income reform, and a reform to the Chilean police. As you can imagine, that is expensive. And we're not growing enough. So we're running more deficit, we're getting more debt, and we have to be careful. I end this fourth point saying that there is a huge crisis of leadership. Mr. Henderson mentioned yesterday this idea quoting Alito When Alito was saying in the past that a small group of leaders can make a difference. The leadership today? The President's approval yesterday in the SEP survey, the most reputed survey, quarterly survey in Chile, six percent approval of the President – the lowest in our history. Congress: three percent. Political parties: two percent. So it's not a problem of the government; today we have a problem in the political system.

In order to finish this ten minutes, a couple of final comments. I think we have enough reasons to be pessimistic. But we need to fight. We need to fight. And here are some grounds for the fight, or ideas to keep in mind. First, middle class values are consistent with free market ideas and freedom, and we have a large middle class. But we need to connect – and I go to the previous panel – to common sense and good proposals and ideas. Number two: we are a small country, only 17 or 18 million. We are not yet sure of the amount, but a small country. You can make a difference in a small country. Number three: a small group of leaders already did that in the seventies and eighties, so we know that's possible. We know that's possible. Finally, for the Mont Pelerin Society, I want to mention that the international community should play a role keeping an eye on Chile, being connected. And also to keep the job that many of you do in different places all around the world training people, providing ideas, generating a good network, and keeping the support for universities and think tanks.

Presentation on "What Happened in Chile?"

Arnold Harberger

Well, first of all, I want to thank Axel Kaiser and Ernesto Silva who have set the stage extremely well for any remarks that I might make. I would like to start with the precipitating factor, which is the bombing of many metro stations simultaneously. That, as Axel said, is something that did not happen by the spontaneous actions of unhappy liberal students. This was something organized and planned and financed and supplied from somewhere. And I think in Chile it is utterly essential that those people who actually did that be identified, found, tried, and imprisoned. And that is one side of the story.

Now, how? And Axel tells me it was a couple weeks later that this rioting took place. Whatever spurred that? Who was involved with that? It was far too many people to have been organized by the cabal that bombed the subway stations. And I think all of us were taken aback by learning about that and what had happened. One of my former students said, "You know, some of those rioters were sons of students of mine." And that bothered me. What are their gripes, I think? People have different problems, but one key feature is that real standards of living have gone up a lot. And certain kinds of benefits, certain kinds of things have not gone up as much, maybe have not gone up at all. Let's suppose that in the United States, our social security system had provided the benefits today per family that it provided when Social Security started and I was a kid in the 1930s? People would have been very happy with that in the 1930s, but by today they would be wanting to demonstrate against the level of poverty to which this condemned them. And you can't say there's any fault in that. Every system should be fully indexed, or something like that. This is just a factual fallout of a country that has had enormous growth and there were some areas where it lagged behind. Recipients of old, traditional social security come into this play and the newer system, which we all like, of individual accounts, there are some people in the individual account system that feel very unhappy. And they tend to be the people who went in and out of the labor force over the years, that weren't contributing all the time. So when they weren't contributing, they weren't getting. And we can tell them, "Look, you're getting the same rate of return" or something like that. But that doesn't help their dinner table. So there's that kind of a problem.

Then, there's another kind of a problem, that somewhere along the line I was told actually it took place in the socialist government, that it became easy for for-profit universities to start. And some of these for-profit universities were like our University of Phoenix and ITT. I hope some of you know the scandal of that, that these are universities that provide a D- or F+ education and charge an A- or B+ tuition, most of which is paid by the government. But people who come out of that kind of inferior educational system can't get jobs, and they have every good reason to feel they have been put upon. So, they have to be part of the story. So, all of that is there.

Yet, there is also an element that has been called attention in a paper that was sent to me, about the sort of elitism in Chilean society. And I have my own little private story to tell. With the Chicago program with Catholic University didn't come at our initiative or at the head of Catholic

University. It came at the initiative of the director of what is now US foreign aid in Chile. He had been visited by our chairman, TW Schultz, a very great economist. They had had a long dinner, and Schultz had been expounding on his views about Chile, Latin America, etc. And Patterson, who was this head guy, was just blown away. He said, “This is the kind of economics that this country needs.” So he wrote letters to the University of Chile and the Universidad Catolica, and at the University of Chile there was a big deanship fight going on, and so the letter remained unopened on the desk of the absent dean, and the Catholic University responded the next day to the effect that it was just delighted. And we four of us, T.W. Schultz, Earl Hamilton, Simon Rottenberg, and myself went down as a committee of Chicago people to examine, see if it was worthwhile for us and under what terms to enter into this arrangement with the Catholic University. And we did. Well, in the course of our ten day or so stay there, we were taken to factories, to dams, to the coast, to ports, to this to that and many times we had lunch in what is called their Union Club, right next to the stock market in the center of town. And I, being very proud all the time of how people have risen from Abraham Lincoln to the current generation – no, no, the current president doesn’t fit into this category, but certainly Clinton, Reagan, came out of the bottom of society. And I’m so proud that my country was able to do that. So here I am at the Union Club, and we’re talking about the farm workers, so-called inquilinos. And I ask, how many inquilinos, how many children of inquilinos, are members of this club? Well, it would be no surprise if every single member of the club sitting around that table fell so far back in his chair that it fell on the floor. Just utterly unthinkable! 1955. July.

So, I am an impish person at heart, and I happened to be invited to the Union Club around 2005. And so what did I say? I’m going to try it again. I tried it again. Same result. Not an iota of difference in 50 years. And I say, “That is an unfortunate situation.” If you don’t want to call it a problem, don’t call it a problem. It is an unfortunate situation that a country that is so vital and so much growth and so much dynamism should be in that kind of a situation. And I think that as we proceed, more serious effort has to be made to integrate people coming from lower down in the hierarchy. Chile is wonderful at integrating immigrants from Europe. We have had Chilean presidents who were children of immigrants from Europe who came penniless. So, it isn’t that Chile doesn’t know how to integrate. But there is kind of a… perhaps racial type perhaps traditional type distinction that really holds down people at the bottom.

And another story that I myself, that my students are largely from the top tiers of Chilean society, and I’ve always found them to be very open, very humane, very generous, very having a depth of spirit that I like very much. One of them, Miguel Costa, organized the whole program for emphasis on alleviating extreme poverty in the early days of the military government. They’re okay. But I get news from people who are on boards of directors in Chile, that the average board of directors will just laugh if somebody mentions adding a woman to the board of directors, for example. They make jokes about it. So, there are that kind of problems in the situation.

So, I keep my fingers crossed. I am hopeful for the future of Chile. I’m still extremely puzzled by what has happened, and I hope and pray that they find a good way out.

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Restoring Liberty for American Indians

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In their book, *The Narrow Corridor: States, Societies, and the State of Liberty*, Daron Acemoglu and James Robinson (2019) describe the delicate balance between the despotic state and anarchy as a narrow corridor in which liberty exists. Too much of either and liberty is threatened. Using numerous examples from ancient history to the present, they demonstrated that the institutions necessary for maintaining that balance are difficult to build and fragile.

As modern states have grown in size and scope, they have usurped individual freedoms sometimes for the benefit of the collective and sometimes for the benefit of those with power. Moreover, because modern states often operate within larger collectives—the United States, the European Union, NATO, WTO, to mention a few—states themselves sacrifice their sovereignty and the liberty of their citizens.

Though Acemolgu and Robinson do not examine Native American institutions, the narrow corridor of liberty provides a useful lens for understanding the history of this most impoverished sub-set of the U.S. population. That history can be fitted into three periods: pre-contact indigenous economies mostly within the corridor; colonial indigenous economies in which the federal government has forced American Indians out of the corridor; and some modern indigenous economies that are fighting their way back into the corridor. Returning to the corridor ultimately requires that Native Americans break out of the bondage created in 1832 when U.S. Supreme Court Chief Justice John Marshall referred to Indians' relationship to the U.S.

government as that of “a ward to his guardian.” Such a relationship is inimical to liberty and holds American Indians hostage to a despotic state by depriving them of jurisdiction over their own lives.

Between Anarchy and Leviathan

American Indians and the tribes to which they belong can teach us much about life inside and outside the narrow corridor. Indeed, the quest for all freedom-loving people is the same as that of Chief Joseph in 1879: “Let me be a free man, free to travel, free to stop, free to trade where I choose, free to choose my own teachers, free to follow the religion of my fathers, free to talk, think, and act for myself.”

On anarchy side of the corridor, life is, as Hobbes put it, “solitary, poore, nasty, brutish and short.” That negative-sum world is further exacerbated when an invader, in Hobbes words,

> hath no more to fear, than an other mans single power; if one plant, sow, build, or possesse a convenient Seat, others may probably be expected to come prepared with forces united, to dispossess and deprive him, not only of the fruit of his labour, but also of his life, or liberty” (quoted at 9, Aceloglu and Robinson (2019)).

The negative-sum nature of human interaction in a state of anarchy provides an incentive for individuals and groups to seek institutions that move them out of anarchy and into the narrow corridor. In Nobel laureate Douglass North’s words, the “major role of institutions in a society is to reduce uncertainty by establishing a stable structure to human interaction” (North 1990, 6). Similarly Richard Posner (1980, 53) suggested that, “It is actually easier to explain why efficiency would have great social survival value in the primitive world than to explain this for our world. . . . Archaic societies sufficiently durable to have left substantial literary or archaeological remains and primitive societies sufficiently durable to have survived into the nineteenth century . . . are likely, therefore to be societies whose customs are efficient." To "efficient," we can add "free" on all the dimensions sought by Chief Joseph.

As Acemoglu and Robinson articulate, the institutions that enable a movement from anarchy into the narrow corridor are not necessarily dependent on the state as we know it today.

> Norms determine what is right and wrong in the eyes of others, what types of behavior are shunned and discouraged, and when individuals and families will be ostracized and cut off from the support of others. Norms also play a vital role in bonding people and coordinating their actions so that they can exercise force against other communities and those committing serious crimes in their own community. . . . . they are critical when the Leviathan [state] is absent because they provide the only way for society to avoid Warre [anarchy] (19).

American Indian institutions depended much more on customs and norms than on formal compacts that we think of as the state, though the latter were often important for encouraging peace on geographic and cultural margins between indigenous groups.

The boundary on the state side of the corridor is the difference between the despotic state and the shackled Leviathan, as Acemoglu and Robinson refer to it. The despotic state is a predatory state--one in which the power of Leviathan is used to take from one individual or group and give to another—and the shackled Leviathan is a productive state—one in which state power is used to overcome free ridership for the purpose of producing public goods. The key for staying within the corridor is granting sufficient power to the state for overcoming free-ridership while preventing that power from being used for despotic purposes.

Acemoglu and Robinson argue that maintaining a shackled Leviathan depends on the Red Queen effect. That is, like the Red Queen and Alice in Wonderland who race one another but never get anywhere, the state and society run fast to maintain the balance between them. If the state can actually outrun society, despotism is the ultimate end-state; if society can keep up with the state, Leviathn can be shackled. For example, in the context of Native Americans, the institutions that determined whether they were in or out of the narrow corridor were mainly determined by culture and tradition. As such, the constraints on norms or the state had to be consistent with social constraints in order to survive. As will be discussed below in the context of the Northern Cheyenne, "government and spirituality must be together for tribal harmony and to prevent corruption" (Spotted Elk, 2012, 1).

In, Out, and Back into the Narrow Corridor

The history of the Native American in and out of the corridor of liberty, falls into three periods. Prior to and shortly after European contact, Native Americans had clear ownership claims, some of which were private and some communal, all of which were well defined and enforced. They took advantage of specialization and engaged in trade, and they understood the importance of collective governance structures and adapted those structures to their changing environment. That initial period, which I refer to as old indigenous economies, was mainly inside the narrow corridor.

Even before they were relegated to reservations, however, American Indians were subject to colonial-type institutions that left them with incomplete property rights subject to the trusteeship until the federal government deemed them “competent and capable” of managing their own assets. Under the umbrella of trusteeship, capital formation has been difficult and costs of resource management have been high. Jurisdiction over territory within reservation boundaries has been attenuated and governance structures, more or less, have been delegated from Washington and not allowed to incorporate tribal customs and culture. I refer to this period as colonial indigenous economies.

To renew indigenous economies, some tribes have begun re-establishing ownership claims to their land and other resources and clarifying tribal jurisdictions and governance structures, both of which have moved them closer to the narrow corridor. These renewed indigenous economies are moving Native Americans back into the narrow corridor of liberty.

In the Corridor

The history of old indigenous economies shows that both had informal and formal (though not necessarily written) institutions that promoted productivity and liberty. At the individual level, Indians used varying degrees of private ownership or control of assets for everything from household goods to horses to hunting and trapping territories. They marked territories with stones and trees, painted their horses to signify ownership, and decorated arrows to indicate who should be rewarded for providing buffalo meat. In short, they knew the difference between mine and thine.

As legal scholar James Huffman (1992, 907) concluded,

> It is not entirely true that Native Americans knew nothing of ownership. The language of common law of property, like all of the English language, was unfamiliar to them. But the concepts of the tenancy in common was not foreign to bands and tribes who claimed and defended entitlement to hunting and fishing grounds. Nor was the concept of fee simple title alien to Native American individuals who possessed implements of war and peace, and even lands from which others could be excluded.

Just as old indigenous economies had property rights that governed the ownership of human and physical capital, they had governance structures for collective units formed for providing protection and production of public goods. Families, clans, and villages were the most fundamental collective institutions. Most of the order came at local levels of families and clans. Speaking of the Basin-Plateau Indian groups, Steward (1938, 246) observes that “political groups and chiefs had no interest in disputes, criminal or civil, between individuals. These were settled by relatives, usually close kin.” According to Lowie (1920, 415), “most difficulties were settled by individuals and their kindred” for offenses such as adultery, homicide, trespass, assault, and theft. Hoebel (1954, 294) summarizes the decentralized nature of social sanctions this way: “The community group, although it may be ethnologically a segment of the tribe, is autonomous and politically independent. There is no tribal state. Leadership resides in family or local group headmen who have little coercive authority and are hence lacking in both the means to exploit and the means to judge.” According to Hoebell (1954, 184), the Comanche tribe “was no more than a congeries of bands held together as a peace group by the bonds of common tongue and culture. There appears to have been no machinery for institutionalized political action on a tribal scale.” Though the “peace chiefs” had no “law-speaking or law-enforcing authority” (1954, 30), they provided a clearing house for information passed from one generation to the next. The chief in the Basin-Plateau Indian tribes was one who "was principally to keep informed about the ripening of plant foods in different localities, to impart his information to the villagers, and if all the families traveled to the same pine-nut areas, to manage the trip and help arrange where each was to harvest. . . . His authority, however, was not absolute. Any family was at liberty to pursue an independent course at any time" (Steward 1938, 247). If the chief "lost his following" (Hoebel 1954, 132), those who provided better information obtained a new position of power and influence.

During battles or hunts where scale economies called for larger collectives, Indians formed societies and other productive units to coordinate activities. More centralized authority was applied mainly "(1) to regulate the communal hunt; (2) to regulate tribal ceremonies; (3) to settle disputes, punish offenders, and preserve order in camp; and (4) to regulate war parties and restrain such at inopportune times" (Provinse 1955, 351). Driving buffalo over a pishkun or buffalo jump, for example, required the coordinated effort of many people, what economists call scale economies. Therefore, the hunt chief had considerable authority to coordinate the drive and received a larger, more desirable share of the meat. Anthropologist John Ewers (1969, 155) captures the difference between sanctions in large and small groups: "If the camp was a tribal one, the chief . . . proclaimed that the prohibition against individual hunting was in force," but "this regulation was less common in smaller band camps."

Among the Yurok Indians of the Pacific Coast, offenses including murder, adultery, theft, poaching, curses, and even minor insults could be prosecuted by following specific legal procedures. Economist Bruce Benson found that both the offending and defending parties in a dispute would hire "crossers," nonrelatives from another community, who "would act as gobetweens, ascertaining claims and defenses and gathering evidence. The crossers would render a judgement for damages after hearing all the evidence" (1992, 29). Finding the defendant guilty, crossers would require payment for damages. "Every invasion of person or property was valued in terms of property, and each required exact compensation" (Benson 1992, 30), with enforcement coming from self-help rather than through a central authority.

At whatever the level of collective activity, there are two important questions: who is included in the collective unit and how are collective decision makers held accountable for whether they increase or decrease the productivity of the collective unit. Who is included depends on many things including blood relations, language, geographic territory, and objectives of the collective unit, to mention a few. Accountability can be conditioned by familial relations where individuals share common objectives and where results for the group are more transparent or by formal rules that specify how collective decision are made and how those making collective decisions are held accountable. Centralized, hierarchical leadership may work because the process for choosing the leader evolves over a long period and selects for leadership traits such as knowledge of the natural environment and preferences of group members. Accountability is also related to the cultural constraints placed on a group leader, and traditions, rituals, and taboos constrain the power of centralized leadership.

Perhaps the most important constraint on a leader's ability to use coercion is the ability of individuals to exit from the collective. For example, when hunting required more people to capture scale economies associated with stampeding buffalo over a cliff, the leader had more power over individuals in the group because exiting from the group meant hunting in smaller, less efficient, hunting units. With the arrival of the horse, however, scale economies in buffalo hunting declined making smaller groups more productive and increasing the potential for exit, especially for those who owned horses and were experienced riders.

The property institutions and governance structures that generated efficiency gains in old indigenous economies were not stagnant, but rather evolved with changes in resource endowments and technology. As anthropologist Peter Frab noted, “Long before Darwin and Wallace brought biological evolution to the attention of the world in 1858, observers of the American Indian had recognized that evolution occurs in cultures” (1968, 6). Economist Martin Baily suggests the institutional evolution was driven by necessity: “In more developed societies, departures from optimality mean lower living standards and lower growth rates—luxuries these societies can afford. By contrast, in societies near the margin of subsistence, with populations under Malthusian control, such departure had harsher effects. … Unsound rights structures generally implied lower population size and, perhaps, the disappearance of the society” (1992, 183). The mere fact that Native Americans survived and thrived for millennia tells us that their institutions were continually adapting to capture gains from evolution.

Though it is impossible to definitively measure the wealth effects of institutions in pre-contact societies, the historical record does include the height of many Plains Indians, and height is a good proxy for health and prosperity. Steckel and Prince (2001) use data on the height of Native American males to measure health and prosperity.

> In a sample of 51 Native American groups, involving about 9,000 individuals who lived in North, Central, or South America over the past several millennia, two equestrian Plains tribes (northern Cheyenne and Crow) were among the three tallest to have lived in the hemisphere. . . . Average heights in both tribes exceeded that of nineteenth century U.S.

> soldiers. As expected based on diet and likely exposure to disease, the equestrian Crow and Cheyenne were somewhat taller than Plains village tribes and considerably taller than tribes who lived near the edge of subsistence—pre-Columbian tribes of the southwest and the collapsing Mayans. (290)

Their conclusion: “Plains nomads were the tallest in the world during the mid-nineteenth century,” because they “were remarkably ingenious, adaptive, and successful in the face of exceptional demographic stress” (Steckel and Prince 2001, 287).

Sheldon Spotted Elk (2012) provides an excellent example that highlights the fine line between norms and the state and eloquently describes the Northern Cheyenne traditional constitution. Several points are worth emphasizing. First, under traditional Cheyenne constitution, as opposed to the constitution virtually forced on the tribe by the Indian Reorganization Act of 1934, “government and spirituality must be together for tribal harmony and to prevent corruption” (1). The glue was provided mainly by ceremonies such as the Arrow Renewal, Sun Dance, and Animal Dance. In this sense, norms were crucial for keeping the tribe in the narrow corridor. On the other hand, the informal governance structure had all of the trappings of a state. The Council of Forty-Four was the primary governing body, made up of”a variety of representative political and person interests” (7). There was separation of powers. For example, to become a chief in the Council of Forty-Four, a Chief of a Military Society had to relinquish his military post in order “to prevent any conflicts of interest that might arise with a Chief fulfilling his foremost duty of peace while leading a military expedition” (8). “Even though political power was shared between the two governmental entities, he Military Society and Chief Society, the Military Society, had limited power” (8).

> Traditional Cheyenne government is not a central government led by a strong executive leader; rather it is spread out among the Chiefs, society leaders and the tribally-oriented. Before the Northern and southern branches divided in the mid-nineteenth century, all the bands would gather together every summer to appoint new political leaders and to perform renewal ceremonies for the tribe. (8)

Even after being relegated to a reservation, the Chiefs "determined where villages were to be set up, when to move, and how to deal with deviants among the tribe. Their function was parliamentary in nature—establishing the traditions and law of the people—and as a judiciary—interpreting the law" (3). In sum, tradition Cheyenne law protected the tribe from anarchy on one side of the corridor and despotism on the other.

Perhaps the best example of Native American institutions that existed both inside and outside the narrow corridor comes from the Sioux tribes that inhabited a region from the Great Lakes to the northern Great Plains. In his book, *Lakota American: A New History of Indigenous Power*, Pekka Hämäläinen (2019) documents how this collection of Native Americans organized themselves in to a formidable force to be reckoned with by other tribes and by the European invaders. The Sioux tribes "were numerous and united. Their numbers were estimated around thirty thousand at mid-seventeenth century, and their many villages possessed a strong sense of common ident as the *Ochethi* Sakowin, the Seven Council Fires" (Hämäläinen, 15). This collection was "not a formal state or confederacy," but rather "was constructed from the bottom up, with language and kinship as the main cohesive" (Hämäläinen, 16). These bottom up institutions kept the Sioux tribes out of the Hobbesian jungle and created a fluid society "that stitched it together by creating a thick lattice of kinship ties that transcended local and regional identities" (Hämäläinen, 17).

Though this fluid amalgam may not have been a formal state or confederacy, it united the Sioux into a formidable nation with power in the eighteenth century that was unsurpassed by other Indian tribes. If the despotic state created by this power did not exploit members of the Seven Council Fires, it afforded the Sioux with war powers used "to protect their lands, to exact revenge, to secure hunting and trading privileges, to enhance their power and prestige by taking slaves, [and] to preempt threats" (Hämäläinen, 17). In the context of Acemoglu and Robinson, Lakota America was a "shackled Leviathan" for tribal members but a despotic state for outsiders.

Out of the Corridor

Duane Champagne (2006) notes that "colonization has come to mean any kind of external control, and it is used as an expression for the subordination of Indian peoples and their rights since early contact with Europeans." As the history of *Lakota America* documents, howerver, it was not until the nineteenth century that colonization of American Indians took its full force. Once relegated to reservations following the Indian Wars, Native Americans struggled to find ways to adapt. Though some tribes shifted to producing for markets—for example the Blackfeet shifted from hunting buffalo to raising cattle for sale to the railroad passing through their territory (Carlson 1992)—most found themselves at the mercy of the federal government. That mercy included the imposition of institutions ill-suited for their lands or their cultures.

In particular, the Dawes Act of 1887, also known as the General Allotment Act, required that reservations be surveyed and parceled to individual Indians—mostly in 160 acre parcels, but in some cases up to 360 acre parcels. During the allotment era, the Indian land base shrank considerably. By 1933, reservations contained 29,481,685 acres held in trust for tribes, 17,829,414 acres held in trust for individual Indians, and 22,277,342 acres owned in fee simple (Flanagan et al. 2010).

Though most studies of the effect of allotment focus on transfers out of Indian ownership, whether tribal or individual, the institutional legacy of the Dawes Act has been to force Indians out of the narrow corridor. This is particularly evident in the 1906 Burke Act, which amended the Dawes Act, in an effort to prevent lands from being transferred out of Indian ownership. It did this by requiring the Secretary of the Interior to assess whether Indians were "**competent and capable**" (emphasis added) before they could be granted fee-simple title to their allotments.

Many studies have documented the efficiency effects of allotment. Allotted trust lands cannot be used as collateral on loans, cannot be leased or transferred without approval from the BIA, and cannot be willed to a single heir (Carlson 1981). The first two restrictions increase the cost to allottees of leasing or changing land use and the third has increased the costs over time by increasing the number of owners for each parcel as trust lands were passed in equal shares to heirs (Shoemaker 2003 and Russ and Stratmann 2016).

Economists who have estimated the effects of allotment generally find that allotment increased the gap between trust land and fee simple land productivity. Carlson (1981) finds a gap in farming activity between Indians and non-Indians, which increased over the allotment period, particularly after 1915, arguing that trusteeship undermined pre-existing systems of informal property rights. Anderson and Lueck (1992) find evidence that agricultural productivity on 39 reservations was highest on fee simple lands during the 1980s. Akee (2009) finds that allowing long-term leasing of trust lands to non-Indians increased the value of trust lands on the Aqua Caliente reservation, because such leasing provides a way around the constraint on alienation. Russ and Stratmann (2015) analyze 12 reservations and find that fractionation correlates with lower per capita incomes at the reservation level, and with reduced lease income from farming at the parcel level. Russ and Stratmann (2016) also find that efforts to reduce fractionation have been unsuccessful.

BIA trusteeship goes beyond land management alone to include other natural resources such as coal, oil and gas, and timber. Just as it has thwarted more productive use of land, trusteeship has limited the ability of tribes to manage and profit from other resources. Though federal paternalism has been described as a responsibility "to protect Indians and their resources from Indians" (American Indian Policy Review Commission on Reservation and Resource Development, quoted in Morishima 1997, 8), there is ample evidence that the BIA has failed to be a good guardian, not the least of which was the 2009 settlement of the long running class-action lawsuit in *Cobell vs. Salazar*. The plaintiffs claimed the U.S. government mismanaged Indian trust assets, including money deposited in trust accounts, and therefore owed the beneficiaries billions of dollars. Eventually the government settled for $3.4 billion, likely a small fraction of what was actually lost.

The consequences of trusteeship, however, go beyond the efficiency effects by limiting individual and collective jurisdiction for Native Americans; i.e. trusteeship has forced American Indians out of the narrow corridor. The land that has been transferred out of trust into private ownership is not under the jurisdiction of the tribe, thus complicating a tribe's jurisdictional authority. In the context of federalism and within the constraints of the U.S. Constitution, states are able to determine their jurisdictional authority, and ideally, tribes could do the same. For some tribes, the optimal arrangement might be local definition and enforcement of criminal, family, commercial contracts, and deciding whether to opt out of trusteeship. For other tribes, the optimal arrangement might include non-local enforcement of commercial contracts. Unfortunately, the history of tribal jurisdiction has been anything but a free choice for tribes. Moreover, tribal governance structures in colonial indigenous economies have not had an opportunity to evolve into shackled Leviathans. Under the 1934 Indian Reorcanization Act "Tribal governments generally operated under boilerplate constitutions that had emanated from the federal government in the 1930s" (Cornell and Kalt 2010, 11). These constitutions do not interface well with historic tribal institutions that enabled old indigenous economies the opportunity to live within the corridor.

Returning to the Corridor

The foundation for renewing indigenous economies is built on three important blocks: well-defined and enforced ownership rights; clear tribal jurisdiction; and clearly enforced and stable rules of governance. As economists Daron Acemoglu and James Robinson (2012) explain in *Why Nations Fail*, "economic institutions that enforce property rights, create a level playing field, and encourage investments in new technologies and skills that are more conducive to economic growth than extractive economic institutions that are structured to extract resources from the many by the few." Or as Manny Jules, chief commissioner of the Canadian First Nations Tax Commission, summarized, the institutional challenge is "about creating the legal, administrative and infrastructural framework necessary for markets to work on First Nation lands, creating a competitive First Nation investment climate, and using economic growth as the catalyst for greater First Nation self-reliance."

Resurrecting and clarifying property rights on reservations must be optional at the tribal level at the option of the tribe. In Canada, for example, a proposal by First Nations to change the

Indian Act takes a step in this direction by letting bands decide if they want out of Canadian federal trusteeship so that bands can decide what the tradeoffs are between lower cost alienation and preservation of the Indian way of life. Under such self-determination, bands could decide if they want to limit alienation to non-band members (see Flanagan et al. 2010).

Clarifying tribal jurisdiction is another necessary step toward creating governance structures for renewing indigenous economies. Jurisdiction not only defines the geographic boundaries that determine what land is under the laws of the tribe, but it also defines what economic activities are governed by tribal governments. Perhaps more importantly, jurisdiction over taxation is crucial for generating revenue to support governmental operations. Doing this is virtually impossible as long as American Indians are treated as wards of the state.

As the relationships between cities, counties, states, and the federal government suggest, land and economic activities can be under many difference jurisdictions. Land use planning might be at the city level while water quality can be governed by the state or federal governments. Businesses are often licensed by local municipalities while product quality regulations are likely under the control of federal regulators.

In contrast to relatively clear jurisdictions under the umbrella of federalism as it applies to municipalities, countries, states, and the federal government, tribes have virtually no jurisdiction, let alone clear jurisdiction. Of course the boundaries of reservations are well defined, but the land within those boundaries is mainly under county and state jurisdiction if it is fee simple land and under federal jurisdiction if it is trust land.

Energy resources, especially oil and gas, offer another example of tribes reasserting their property rights and sovereignty. On the Fort Berthold Reservation in North Dakota, the Three Affiliated Tribes have used special legislation to assert their control of oil and gas leases. The motto of Missouri River Resources, a tribally owned oil company, is "Sovereignty by the barrel." As tribal chairman Tex Hall put it, "The potential here is to obtain financial independence for our nation, education for our youth, sustenance for our elders, maintenance of our culture and above all to set the people of the Mandan, Hidatsa, and Arikara Nation on the road to independence."

Once governments have clear jurisdiction over property rights and business transactions, they face the sovereign's dilemma (see Haddock and Miller 2006). That dilemma is should the government take a larger share of wealth now even if it means that wealth production will decline or should it restrain such taking in order to encourage wealth production. The challenge for tribes is to create governance structures that encourage the former and discourage the latter. Meeting this challenge means having governing rules that limit a tribe's sovereign powers as well as legal processes that enforce these limits.

Conclusion

The poverty that epitomizes American Indian Reservations and the accompanying social ills is due mostly to institutions that have treated Native Americans as wards of the state since the 1830s. Tribes assert that they are sovereign nations, but, with virtually of their resources held in trust by the federal government, tribal governments have little jurisdiction over land, capital, or even tribal members. None of this is because indigenous cultures are inimical to and an obstacle to development.

In order for indigenous economies to enjoy the fruits of prosperity, tribes must find their way back into the narrow corridor of liberty. Crow tribal member, Bill Yellowtail (2006), succinctly describes what it takes to renew indigenous economies: "Indian sovereignty . . . is founded upon the collective energy of strong, self-sufficient, entrepreneurial, independent, healthful, and therefore powerful, individual persons. . . . The proper economic role for tribal government is to facilitate private enterprise . . . with an eye toward building the capacity of individuals and families to be truly independent." That capacity building can only take place if American Indians are, as Chief Joseph concluded, "free to talk, think, and act" for themselves.

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More recently he has focused his research and writing on how the ideas defining a free society apply to Native American economies. Of his thirty-nine books, four have laid the foundation for his Renewing Indigenous Economies project (indigenousecon.org). The most recent of these books is *Unlocking the Wealth of Indian Nations*. He lives in Montana with his wife, Monica, where they enjoy fishing, hunting, horseback riding, and skiing in Big Sky Country.

The Effect of Economic Freedom on Labor Market Efficiency and Performance

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Introduction

The *labor market* is the centerpiece of every economy. It determines how society's human resources are utilized, both over time and across individuals, and how much workers are compensated for their labor services. In all countries, the labor market is the largest market in the economy, with workers receiving roughly 60 percent or more of the total income that is generated by market production.

An equally important issue is how well the labor market functions. The difference between a poorly- functioning labor market and a well-functioning labor market can mean millions of lost jobs and billions of dollars in lost incomes.

Government policies and institutions have important effects on the efficiency of the labor market. In some economies, such as the United States, labor markets are not heavily regulated, tax rates are fairly low, and economic freedom is relatively high. In some other countries, labor markets are heavily regulated, tax rates are high, and consequently there is less economic freedom.

This paper summarizes research on how government policies that affect freedom of choice within the labor market impact its performance and efficiency. These policies include taxation, minimum wages, unionization, and occupational licensing requirements.

This review shows that freer labor markets, which have lower tax rates, less regulation, and more competition are much more efficient and dynamic, and are associated with higher employee compensation, greater employment, and significantly higher incomes than labor markets with more regulation and higher taxes.

These findings have important implications for economic policy making. They indicate that policies that enhance the free and efficient operation of the labor market significantly expand opportunities and increase prosperity. Moreover, they suggest that economic policy reforms can substantially improve economic performance in countries with heavily regulated labor markets and high tax rates.

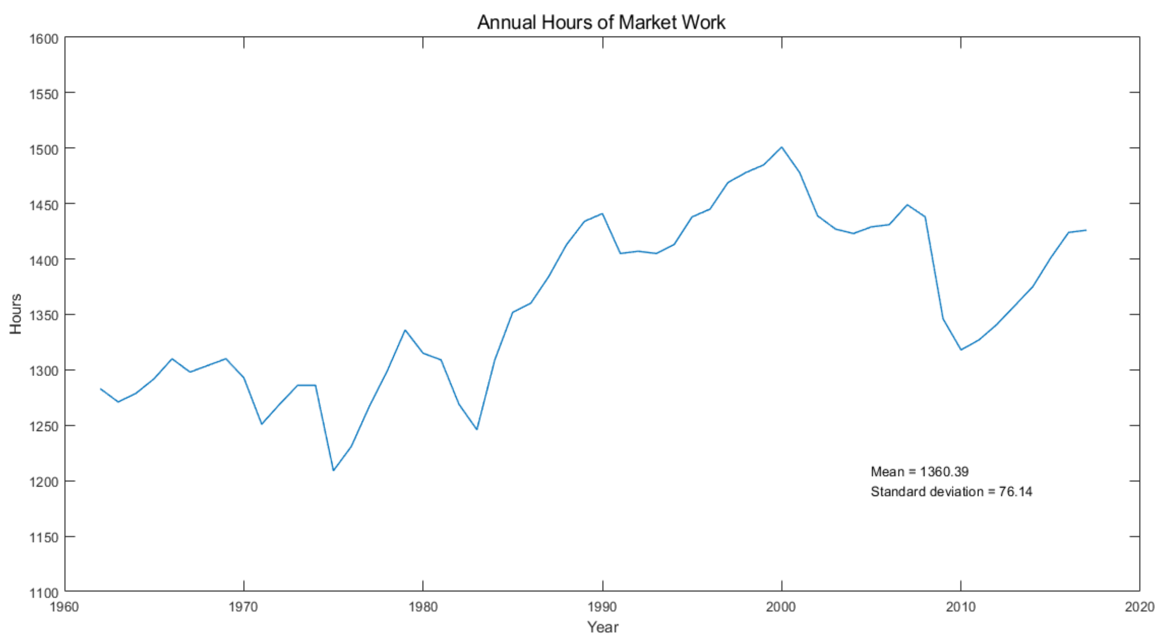
The U.S. Labor Market: Stability Enhances Economic Growth

This section presents employment, hours worked, and employee compensation data to summarize the performance of the U.S. labor market. These data will show that the U.S. has a very dynamic labor market that absorbs the large number of new workers constantly entering the labor force and that also reallocates workers across sectors in response to the enormous changes observed in economic and social conditions that have occurred since 1960.

This section will also show that U.S. worker compensation has increased over time at nearly and that the shares of income paid to labor and capital have been roughly constant over time after adjusting for capital depreciation.

Figure 1 shows the total number of market hours worked in the United States relative to the U.S. working age population, whom are those between the ages of 16 and 64 years. This is the most complete measure of market work, because it combines employment data with the number of hours per worker. This ratio is naturally interpreted as the average annual number of

Figure 1 Annual Hours of Market Work

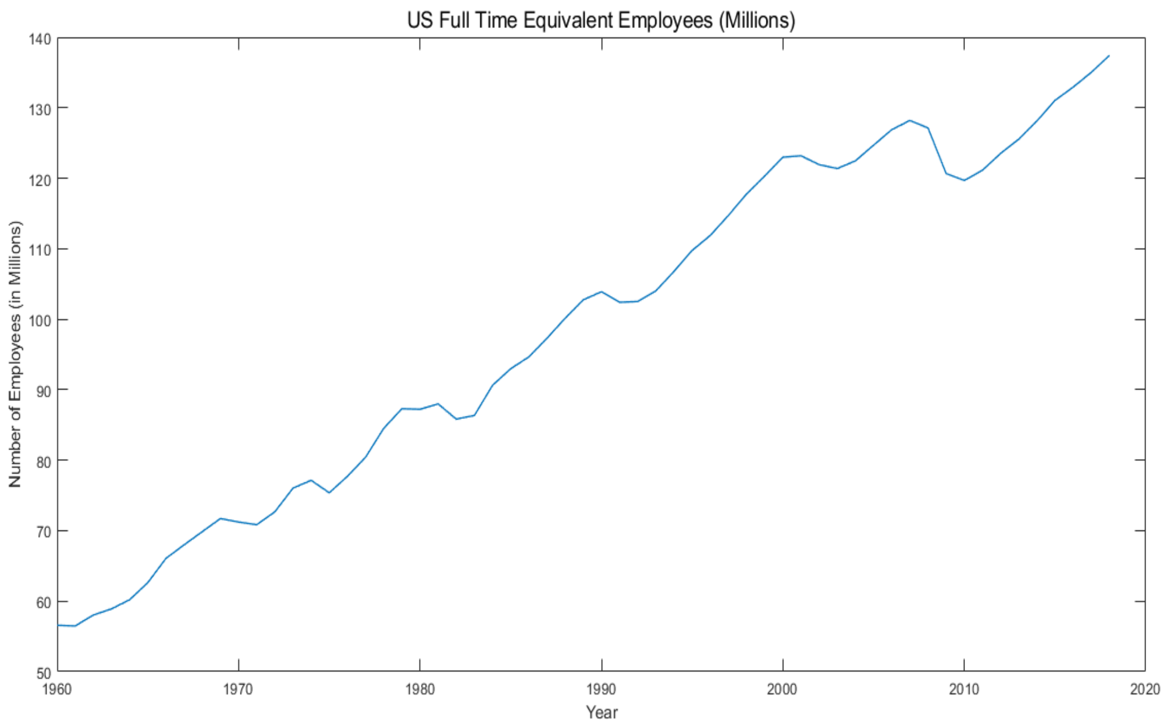


market hours worked per U.S. adult. The data are compiled by Cociuba, Prescott, and Uberfeldt (2018).

Standard economic principles indicate that hours worked per adult should be relatively stable in a well-functioning market economy. These data are largely consistent with this view. The average annual hours worked per adult per year in these data is about 1,360 hours, with a standard deviation of just 76 hours per adult per year, which is about six percent of the mean.

The stability of U.S. hours worked per adult is associated with enormous employment growth. Figure 2 shows the number of full-time equivalent U.S. employees since 1960. These data, which are constructed by the Bureau of Labor Statistics, highlight the dynamism of the U.S. economy. Full-time employment grew smoothly from about 56.5 million full-time equivalent workers in 1960 to about 127.5 million in 2018. This is a gain of about 142 percent.

Figure 2 US Full Time Equivalent Employees (Millions)



While there are some fluctuations from trend growth, particularly around the recessions of the early 1980s, 2000-01, and 2008-09, the otherwise fairly smooth operation of the U.S. labor market is striking. Looking at these graphs, one would be hard pressed to identify many of the large economic and social changes that occurred over this period and that could have significantly impacted the labor market's ability to absorb and allocate workers.

One such factor is the 38 million person Baby Boom cohort that entered the labor market between the late 1960s and the early 1980s. This large influx of young workers did not disrupt the U.S. labor market. Rather, the graph shows that the labor market readily absorbed this massive increase in the supply of new workers.

Another major factor impacting the labor market has been an ongoing shift from a goods-producing economy to a services-producing economy, in which manufacturing's share of employment declined from more than 25 percent in 1960 to less than ten percent today.

The substantial increase in labor force participation of women has been another key factor impacting the labor market. Women's participation rose from just 35 percent in the mid-1950s to about 60 percent by the mid-1990s.

There are other significant factors that affected the U.S labor market since 1960. These include the enormous increase in globalization of production, investment, and trade, and the development of information and communications technologies, which in turn gave rise to transformational businesses including Microsoft, Apple, Google, and Amazon, among others. These businesses have not only completely changed several major sectors of the economy, but also have created enormous cultural and social change.

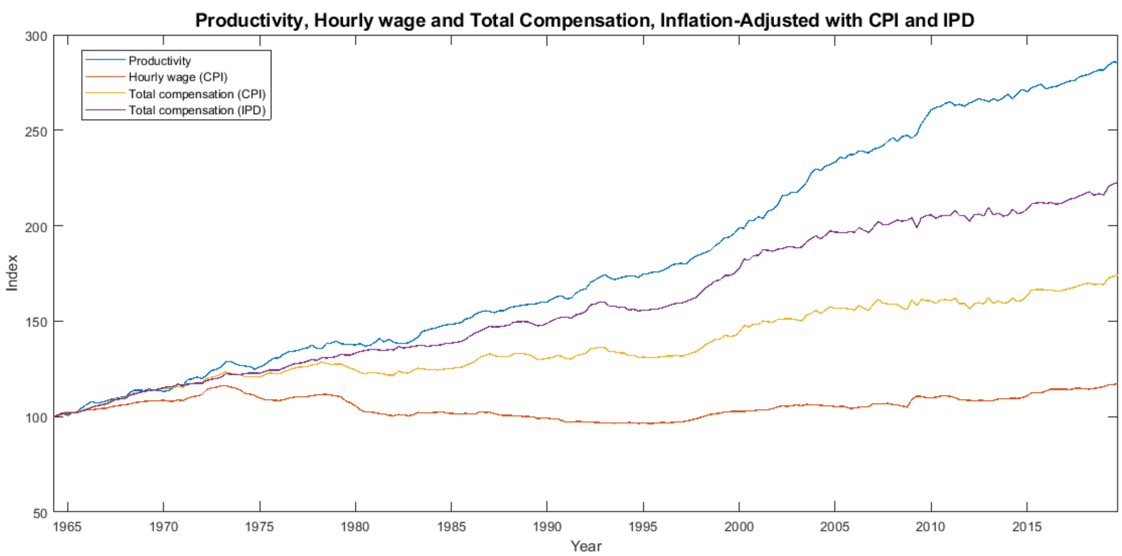
All these developments were permanent, game-changing events in the history of the U.S. economy, yet the U.S. labor market responded to these changes by efficiently absorbing new workers and also reallocating workers across firms, industries, and sectors.

The rapid reallocation of labor is particularly striking in the U.S. About four percent of U.S. employment turns over every month, as workers leave existing positions and move to new positions. With a current employment level of about 132 million workers, this means the equivalent of about 65 million job changes in the U.S. each year.

This remarkable level of job reallocation highlights a rapidly evolving and growing economy, in which the labor market quickly moves workers from slower growing firms and industries to more rapidly growing firms and industries.

The next two figures present data on average worker compensation, which is the price of labor. These two figures clarify two commonly held, but misunderstood views about worker compensation and the distribution of income. One misunderstood view is that inflation-adjusted compensation has grown very little over time. The other is that the distribution of net

Figure 3 Productivity, Hourly Wage and Total Compensation, Inflation-Adjusted with CPI and IPD



income has substantially shifted from workers to capital.

In a competitive, well-functioning labor market, worker compensation grows with worker productivity. Higher productivity means higher value-added, and growing worker productivity leads businesses to bid up compensation as they compete for workers.

Figure 3 shows real GDP per worker, which is the most common measure of economy-wide labor productivity, along with three different measures of inflation-adjusted compensation, two of which are commonly used, but are plagued by significant conceptual and measurement flaws. Taken together, these three series show why some commentators claim that compensation has grown very little over time, and that it has not nearly kept up with productivity increases, and why these views are mistaken.

The brown line shows worker wages divided by the Consumer Price Index (CPI). This measure is frequently cited by commentators who argue that workers have not received any significant, inflation-adjusted salary increase for decades, even though their productivity has increased. [1]

There are two key problems with this frequently-used measure that makes it inappropriate for inferring compensation growth and for comparing compensation to worker productivity. One is that non-wage benefits, which include employer-provided health plans, and vacation, among other compensation, have become an increasingly large fraction of total compensation.

In the 1960s, non-wage benefits accounted for only about six percent of employee compensation. Today, they have grown to about 1/3 of total compensation, as the value of employer-provided health plans has grown substantially. This large component of compensation is omitted by those who focus just on wages. Moreover, this indicates that while wages may have been a reasonably accurate measure of compensation 60 years ago, they are not today, and should not be used as a proxy measure of employee compensation now.

The second problem with this measure is in terms of comparing it to productivity. This is because the GDP deflator is used to construct worker productivity, but the CPI is used to deflate the wage. Comparing worker compensation to productivity requires that the same price index be used to deflate both measures. The appropriate price index for making this comparison is the GDP deflator, because it is by far the broadest price index available, covering all market goods and services.

It is well known that the CPI overstates economy-wide inflation. This means that wages deflated by the CPI will not only be biased downwards because of omitted non-wage compensation, but also because the CPI grows considerably faster than the GDP deflator.

[1] See Presidential candidate Tom Steyer's recent statement about compensation not growing.

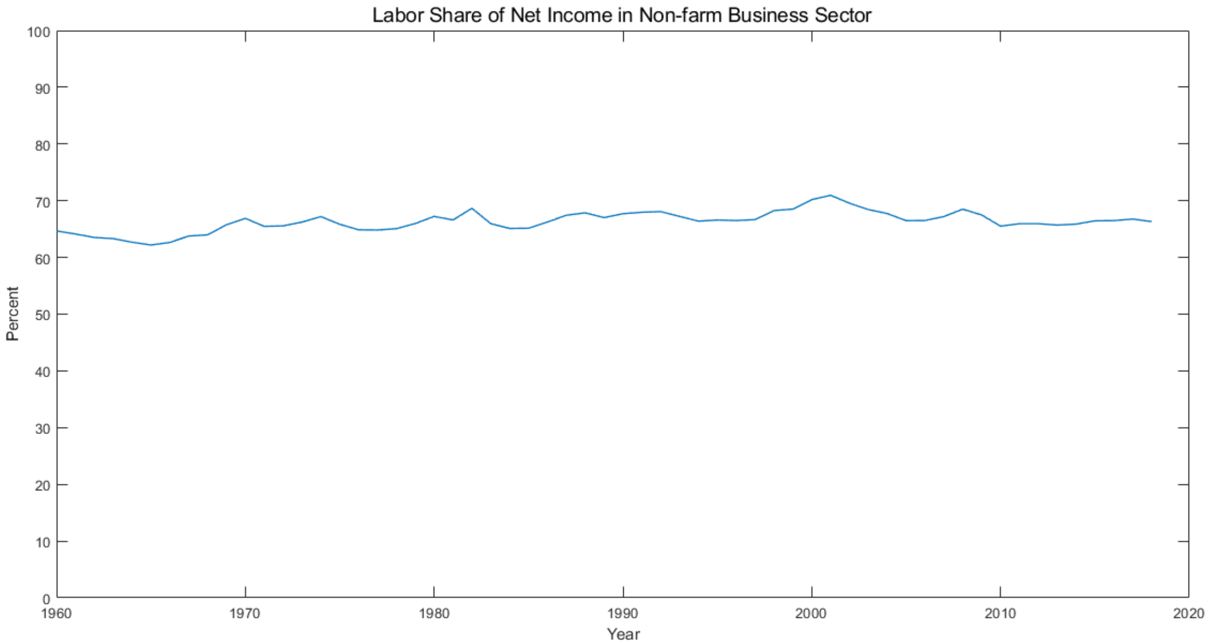
To see how much the errors of (1) using wages rather than total compensation, and (2) using the CPI instead of the GDP deflator matter for these issues, Figure 3 shows two additional measures, which are total compensation deflated by the CPI, and the appropriate measure for comparing to productivity, total compensation divided by the GDP deflator.

The figure shows that total compensation deflated by the CPI grows over time, in contrast to wages. The difference between these two measures shows the difference between using the appropriate measure of total compensation versus wages, and highlights the large quantitative error induced by using just wages as a measure of living standards.

Total compensation divided by the GDP deflator is the third measure presented in the Figure. This measure shows very strong growth over time. There is some divergence between productivity growth and compensation growth after 2000. Economists are studying potential factors accounting for this divergence. While this presently remains an open question, this divergence has not been caused by a shift of net income from workers to capital, which is another widely-held perception.

Rather, this view about labor's share of the economic pie is largely based on a conceptual error. To see this, Figure 4 shows the distribution of income between labor and capital, net of capital depreciation. The data exclude the self-employed, for which income attribution between labor and profits is ambiguous. The figure shows a relatively constant share of income paid to labor, at about 66 percent. These data stand in sharp contrast to the view that owners of capital are receiving a considerably larger share of net income at the expense of workers.

Figure 4 Labor Share of Net Income in Non-farm Business Sector



Rising capital depreciation rates are the reason why labor's share of income net of depreciation has remained constant, even if its share of gross income has declined. The U.S. Bureau of Economic Analysis has changed the definition of capital investments to now include what are known as intangible investments that previously had been expensed items, such as computer software.

These newly classified investments tend to have very high depreciation rates. In addition to expenditures that are now being classified as capital investments, there is also a greater share of business investment in previously existing, high depreciation categories, such as computer equipment, which depreciates must faster than other investments, such as office buildings and factories.

Higher depreciation means a higher gross payment to capital, all else equal. This is because investors require a specific rate of return, net of depreciation, in order to bear capital risk as well as postpone consumption. This rate of return must allow for depreciated capital that must be replaced. After accounting for higher depreciation, it is striking that the net payments to capital and labor have not changed in any quantitatively important way over time.

Taken together, these data indicate that the U.S. labor market has functioned efficiently over most of the last 60 years in terms of absorbing new workers, reallocating workers across firms, industries, and sectors, and providing compensation that grows roughly with worker productivity and whose share of net income has not changed over time.

U.S. labor market efficiency coincides with a significant amount of economic freedom and lack of economic policy distortions. The next section compares measures of U.S. labor market freedoms with those in some other countries.

Comparing Labor Market Freedom and Policies across Developed Countries

This section provides international perspectives on labor market freedom across countries. This comparison is informative because different countries have adopted very different labor market policies, which in turn have had large effects on the incentives and opportunities within the labor market. This comparison will show that the U.S. labor market is much freer than those in most other countries.

The Heritage Foundation and the Organization for Economic Cooperation and Development systematically rank countries on labor market freedom and flexibility.

Both these rankings have been conducted for many years and they are widely cited and used in making comparisons across countries and analyzing labor market outcomes.

The Heritage Foundation ranks the U.S. as having the most labor market freedom among all countries. The ranking is based on six factors: (1) The minimum wage relative to average value added per worker, (2) the cost of hiring new workers, (3) the cost of adjusting worker hours, (4) the cost of dismissing redundant employees, (5) the length of term of mandated notice of dismissal, and (6) the extent and size of mandatory severance pay. Each of these factors in the Heritage Foundation index has important economic implications for the efficient and free operation of the labor market.

The minimum wage relative to average worker productivity gauges how many workers may be negatively affected by the minimum wage because their employment cost exceeds the value of their production. Specifically, if the minimum wage is higher than a worker's productivity, then the worker will not be hired because the hiring organization will take a loss on that worker. Instead, they will focus their hiring efforts on workers whose productivity exceeds the minimum wage.

In a free labor market, inexperienced workers would have many more opportunities because employers would not be restricted to pay them a wage exceeding the value of their production. Instead, workers would be paid according to their productivity. While inexperienced workers may be paid relatively low wages, their pay would rise as their skills increased with experience and job training.

Those who may be priced out of the market due to a high minimum wage include workers who have not yet acquired sufficient skills to realistically compete for higher wages jobs, such as young workers, immigrants, and workers who have been out of the labor force for a considerable period of time, such as parents who left the labor force to raise children, and workers recovering from long-term disabilities.

The remaining Heritage Foundation measures of labor market freedom are the expenses associated with adjusting and managing a company's workforce. In an efficient and free labor market, these costs should be relatively small on a per worker basis. However, these costs can be significant and may materially affect firm human resource decisions when regulations substantially affect these choices.

These adjustment and management costs include overtime premium and the costs of dismissing redundant workers, including the amount of severance pay and mandated notification period of dismissal notice, as well as litigation costs and penalties for noncompliance.

As these costs rise, they tend to reduce employment and economic activity because they raise the cost of employing a worker without increasing worker productivity. Over time, higher employment costs resulting from regulations will tend to reduce wages.

The OECD’s ranking focuses on what economists refer to as *labor market flexibility.* The OECD measures the extent of regulations on individual and collective job dismissal across countries. These regulations make it more expensive to dismiss workers, which in turn reduce employment by raising employee costs. High dismissal costs also impede resource reallocation across different sectors of the economy, and this also slows economic growth. The U.S. is also ranked first in the OECD’s index.

The Heritage Foundation and OECD measures of labor market freedom and flexibility summarize factors that directly affect business’s demand for labor by affecting the cost of labor. Labor supply, which is the other side of the labor market, is directly affected by other policies.

Some of the most important policies that affect labor supply are tax rates. Tax rates change the incentives to work either by reducing a worker’s take home pay, (labor income taxes) or by making consumption goods more expensive (sales taxes or value added taxes).

In the standard model of labor supply, an individual weighs the costs and benefits of working and chooses how much to work at the point where the incremental cost of working, which tends to rise with hours worked, is equated to the incremental benefit of working, which tends to decrease with hours worked. Higher taxes reduce the benefit of working, which means that taxes induce workers to reduce their labor supply and work less, all else equal.

McDaniel (2007, 2011) has constructed panel data covering 15 OECD countries beginning in 1950. These data have been updated to 2015. These data show that there have been enormous changes over time and across countries in the labor and consumption tax rates that affect labor supply.

Since labor income taxes and consumption taxes have similar effects on labor supply, I have combined McDaniel's data on labor income taxes and consumption taxes into a single composite tax rate by adding them together.[2]

Table 1 shows this composite tax rate for selected countries, including several European countries where these tax rates are particularly high. The data are for 2015, which is the most recent year that the data are available.

Table 1 - Combined 2015 Tax Rate on Labor Income and Consumption, in Percent

Austria	Belgium	Canada	France	Germany	Italy	Netherlands	Spain	UK	US
63.1	58.2	38.7	64.8	55.8	61.5	58.1	47.4	42.7	28.7

The table shows that the U.S. by far has the lowest composite tax rate at 28.7 percent. The composite tax rate for the European countries is much higher, ranging from 42.7 percent (United Kingdom) to 64.8 percent (France).

European tax rates were not always so high. In the 1950s, some European tax rates were lower than the U.S. tax rate. These tax rates rose substantially in the 1970s and early 1980s as many European countries expanded the size and scope of government during that period.

Table 2 shows how these tax rates have changed between 1950 and 2015. The table shows the difference between each country's 2015 tax rate and its 1950 tax rate, in percentage points.

Table 2 - Percentage Point Change in Tax Rates: 1950-2015

Austria	Belgium	Canada	France	Germany	Italy	Netherlands	Spain	UK	US

[2] Labor income taxes and sales taxes on consumption have fairly similar effects on labor supply, as labor taxes reduce take home pay, which reduces the amount of consumption workers can purchase, while consumption taxes raise the cost of the goods, which also reduces the amount of consumption workers can purchase.

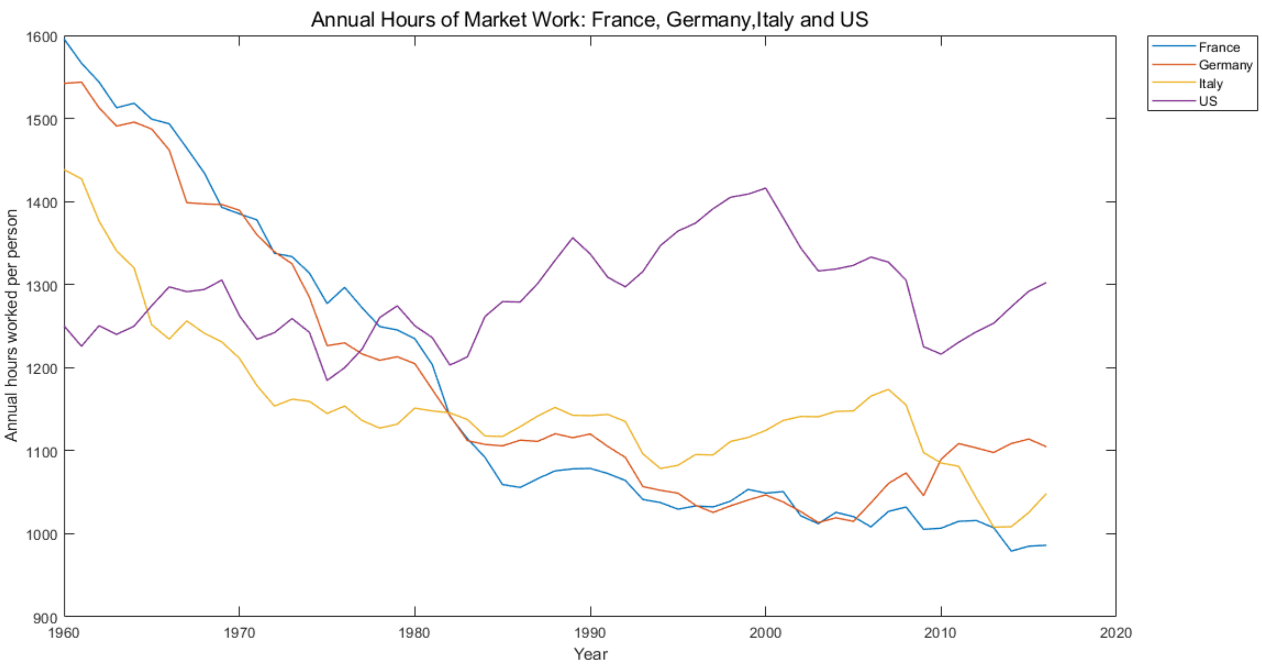
36.7	31.0	19.5	26.1	26.5	36.6	27.9	31.9	17.8	11.6

In Europe, these tax rate increases range from 26.5 percentage point (Germany) to 36.7 percentage points (Italy). The mean tax rate increase among the continental European countries is 31 percentage points. In contrast, the U.S. tax rate increased by only 11.6 percentage points.

The next section summarizes research that uses tax rate data to analyze how tax rates have affected labor supply in the OECD countries.

How Tax Rates and Other Policies Affect Labor Markets across

Figure 5 Annual Hours of Market Work: France, Germany, Italy and US



Countries

Figure 5 shows hours worked per adult for the U.S., and for three major European countries, France, Germany, and Italy. The most striking features of these data is that the large drop in the number of market hours of work in the European countries, which are the countries with the largest increase in tax rates.

Hours of market work per adult in France fall from about 1,600 in 1950 to about 1,000 in 2015. Similarly, hours of market work per adult fall in Germany from about 1,550 to about 1,100, and from about 1,450 to about 1,050 in Italy. These are enormous declines. In contrast, U.S. hours worked change little, rising from about 1,250 to about 1,300.

These very different patterns in hours worked coincide quite closely with changes in the tax rate reported in the previous section. In particular, the composite tax rate increased by about 30 percentage points on average in the three European countries, and hours worked in those same countries declines by about 31 percent. U.S. tax rates rise modestly, and U.S. hours worked are unchanged.

Several studies have found that a standard model of labor supply that includes taxation accounts quite closely for these very different changes in hours worked.

Prescott (2004) studied how changes in tax rates affected hours worked per adult in Canada, Germany, France, Italy, Japan, the United Kingdom, and the United States. He used national income account data to construct tax rates and then used a standard economic model to predict how observed tax rate changes between 1970-74 and 1993-96 changed hours worked. He found that changes in tax rates accounted for almost all the change in hours worked across these countries. He summarizes his main findings as:

"In this article, I determine the importance of tax rates in accounting for these differences in labor supply for the major advanced industrial countries and find that tax rates alone account for most of them." (Prescott (2004), page 2).

Ohanian, Raffo, and Rogerson (2008) also employ a standard model of labor supply and analyze a larger panel of countries, covering 15 OECD countries, and over a longer time period, from 1956-2004. They use the McDaniel (2007, 2011) tax rate series, which was not available at the time of Prescott's analysis.

Table 3 summarizes their findings. The model predicts the significant decreases in labor supply for Austria, Belgium, Germany, Netherlands, and the U.K. The model's prediction error is large for Spain, though that is understandable. Despite higher taxes, Spain implemented many pro-market economic reforms and a shift to more democratic government after Franco left power. Those factors, which positively affect labor supply, likely attenuated the impact of higher taxes.

The Netherlands is a particularly interesting case, because after suffering a nearly 1/3 drop in hours worked per adult, they implemented lower taxes in the 1980s. Following this tax reform, hours subsequently rose by about 12 percent. The model accurately generates the very large drop from the 1950s to the 1980s, and then also generates the partial recovery in hours worked afterwards.

Of the twelve countries that experienced at least a fifteen percent decline in hours worked, tax changes account for about 85 percent of the overall drop.[3]

Table 3 – Actual and Predicted Percentage Change in Hours Worked: 1950-2015

Country	Austria	Belgium	Canada	France	Germany	Italy	Netherlands	Spain	UK	US
Actual	-36	-34	8	-38	-40	-29	-21	-13	-22	4
Predicted	-31	-31	-11	-21	-34	-43	-21	-41	-16	-9

Taken together, these studies highlight the quantitative importance of taxes and how they affect individual incentives to work. Moreover, the findings have important implications for fiscal policy. The sensitivity of labor supply to changes in taxes indicates that relying primarily on tax increases to balance budgets in countries confronting large deficits may significantly depress economic activity. Rather, balancing budgets should include cuts in government spending.

[3] Canada, New Zealand, and Australia were the other countries in the dataset that had small changes in tax rates, and all had relatively constant labor supplies. These countries are omitted from the table because of space considerations.

Economists have studied how other policies have affected labor market performance, particularly unemployment. As discussed in Section 2, Europe has adopted political institutions and economic policies that have increased labor market rigidity and reduced economic freedom within the labor market.

Blanchard and Wolfers (2000) analyzed panel data from European countries to study how the level of unemployment benefits, the duration of benefits, unionization, and employment protection laws, affected European unemployment over time and across countries.

Economists have focused on Europe data because unemployment in many European countries has been much higher than in the United States. Since 1985, French unemployment has average around nine percent per year, and German unemployment has averaged around eight percent per year.

Blanchard and Wolfers found that labor market policies that have increased labor market rigidity and reduced economic freedom have had very large effects on unemployment. They find that the maximum benefit rate, which is the average unemployment benefit measured as a percent of the average wage, has increased European unemployment on average by 1.3 percentage points. They find that the duration of benefits, which has been very high in Europe, increased unemployment by about 0.75 percentage points. Employment protection policies, which raise the cost of dismissing redundant workers, raised unemployment by about one percentage point, and unionization raised unemployment by about 0.6 percentage points.

Taken together, the findings of Blanchard and Wolfers indicate that observed policies could have potentially increased European unemployment by as much as 4.6 percentage points per year. Note that this is the difference between a very healthy labor market, and one that is perpetually in a severe recession or even depression.

In another influential study, Ljungqvist and Sargent (1998) assess how labor market policies affect European unemployment with a focus on long-term unemployment, which is very prevalent in Europe.

They hypothesize that European policies tend to increase long-term unemployment because worker skills deteriorate as unemployment duration rises. In particular, their hypothesis is that some workers ultimately become chronically unemployed as their skills deteriorate so much that unemployment benefits, which have been quite high in Europe, become higher than their market wage. They find that well-intentioned policies account for much of the rise in long-term European unemployment as relatively high, and long-lasting benefits trap European workers in a persistent cycle of unemployment.

These findings have been confirmed for emerging economies. Bernal-Verdugo et. al. (2012) study a panel of 85 countries, many of which are developing countries, and find that "after controlling for other macroeconomic and demographic variables, increases in the flexibility of labor market regulations and institutions have a statistically significant negative impact both on the level and the change of unemployment outcomes (i.e., total, youth, and long-term unemployment). Among the different labor market flexibility indicators analyzed, hiring and firing regulations and hiring costs are found to have the strongest effect. "

Botero et al. (2004) report similar findings from an 85 country study. They find that highly regulated labor markets reduce labor force participation, and raise unemployment, particularly for young workers.

Minimum Wages: Theory and Evidence

At one time, there was nearly universal agreement among economists and policy makers that high minimum wages depressed employment, particularly for young people who were still in the process of accumulating skills and experience.

The economic logic behind this once standard view is simple. Fixing the price of any good or service above its market price will result in lower demand. In the labor market, this means that any worker who does not deliver enough value to offset an artificially high minimum wage will be unemployed.

Youth unemployment statistics highlight the impact of minimum wages. In mid-2012, more than two years after the end of the last recession, teenage unemployment (16 years – 19 years of age) was 25 percent, compared to a 6.7 percent unemployment rate for prime age workers, who are between 25-54 years old.

Even today, with the strongest job market in the last 50 years, teen unemployment is 12.6 percent, compared to prime age worker unemployment of 2.9 percent.

Despite the simple economic logic described above, and the observed large difference in unemployment rates by age, some commentators today hold the view that raising the minimum wage will have little, if any effect on unemployment, and instead will substantially raise the standard of living among nearly all low-wage workers.

Perhaps the major factor driving this change in opinion was research by David Card and Alan Kreuger (2015). In an influential paper, Card and Krueger compared changes in employment in fast food restaurants between New Jersey, which increased its hourly wage from $4.25 to $5.05 in 1992, and Pennsylvania, which kept its minimum wage at $4.25. They surveyed about 400 fast food restaurants near the New Jersey-Eastern Pennsylvania border by phone, and asked restaurant managers about employment levels before and after the New Jersey minimum wage change.

They reported that the New Jersey restaurants had expanded employment by nearly three full-time equivalent workers relative to Pennsylvania restaurants. This result was extremely surprising, as it defies the most basic economic argument that artificially raising wages of low-skilled labor depresses the demand for that labor.

However, there are problems with Card and Krueger's analysis, including data collection and with their research design. In terms of data collection, Card and Krueger relied on telephone surveys with the restaurants. Subsequent research based on better data collection showed very different results.

In a series of papers and a book, David Neumark and William Wascher review many minimum wage studies, including that of Card and Krueger. In contrast to Card and Krueger, Neumark and Wascher redo the New Jersey and Pennsylvania fast food restaurant study by using administrative payroll data from fast food restaurants, rather than telephone interviews. Payroll data is more reliable than the telephone interview responses obtained by Card and Kruger because restaurants have a legal obligation to report taxable income and costs.

In contrast to the Card and Krueger study, Neumark and Wascher found that the higher minimum wage in New Jersey had reduced New Jersey employment by about four percent relative to Pennsylvania, in which the minimum wage was not changed. This finding is in line with standard economic logic and with the majority of previous empirical estimates of the impact of minimum wage.

Neumark's most recent review of many short-run minimum wage studies concludes as follows:

"The preponderance of evidence indicates that minimum wages reduce employment of the least-skilled workers. Earlier estimates suggested an 'elasticity' of about −0.1 to −0.2. Many estimates are still in this range…More definitively, though, it is indisputable that there *is* a body of evidence pointing to job losses from higher minimum wages. Characterizations of the literature as providing no evidence of job loss are simply inaccurate." (Neumark (2019), page 321).

More recently, economists have begun to study the long-run effects of minimum wages on employment. This is important, as the short-run responses to a higher minimum wage, which are the focus of much of the literature, may be very different than long-run responses. This is because it takes time for employers to make adjustments in response to minimum wage changes, including installation of new capital investments, and adoption of new technologies, both of which can substitute for workers.

Research by Isaac Sorkin (2015) shows that the difference between the short-run and long-run effects of minimum wage legislation can be enormous. Sorkin measures the responsiveness of employment to a wage change using the economic concept of demand elasticity, which is the percentage change in labor demand in response to a given percentage change in the wage.

He shows that the contemporaneous elasticity of labor demand can be virtually zero upon impact of a minimum wage change, in which he estimates that a ten percent change in the wage generates an immediate .02 percent drop in employment. However, he finds that this sensitivity rises to -.252, meaning that a ten percent change in the wage generates a 2.5 percent drop in employment after six years, which is roughly a 100 times larger effect than the immediate effect.

This large difference reflects the fact that as labor costs rise, businesses economize on labor by substituting capital and new technologies for workers and also offshore some tasks to lower cost providers of labor services. This large difference between short and long-run effects is incredibly important, but rarely is documented by empirical studies.

Minimum wage research has important implications for current policy discussions. In particular, there are a number of proposals to raise the federal minimum wage from its current level of $7.25 per hour to $15 per hour.

At its current level, the minimum wage affects very few workers, just 0.28% of the labor force. According to the Labor Department, almost half of minimum wage workers are workers less than 25 years old, who account for only about 20 percent of the overall labor force.

However, if the minimum wage was raised to $15 per hour, then it would affect over 40 percent of American workers. Alan Krueger, one of the authors of the New Jersey-Pennsylvania study cited above, and a former economic adviser to President Obama warned of job loss if the minimum wage was raised to $15 per hour.

An important risk of a $15 federal minimum wage is that low earners in relatively poor states would be particularly hard hit For example, the average hourly wage in Mississippi is under $15 per hour.

There are policies that will improve the efficiency of the labor market while promoting compensation growth for those who may be adversely affected by the minimum wage. These policies include expanding the earned income tax credit, increasing the scope and scale of enterprise zones, which incentivize businesses to locate in poor neighborhoods, improving our K-12 education system, and expanding pre-school programs.

The Impact of Unions on Labor Market Performance

This section summarizes how unions have historically affected labor market efficiency and opportunities.

In the late 19th and early 20th centuries, unions focused on increasing worker safety, protecting worker civil rights and supporting education and limiting the use of child labor (see Ohanian (2009))

These efforts were important because labor markets were much less competitive at that time than they are now. In the 19th and early 20th centuries, there were often just a few large employers in a community, which gave employers much more market power than employers have today.

Since worker safety, human rights, and child labor regulations are now well established at both the federal, state and local levels, unions have shifted their focus to increasing compensation and increasing employment, in which the latter is a process known as "featherbedding." A large body of research finds that these aspects of unionization have benefitted union members, particularly in the short-run, but at the expense of others by depressing economic growth, particularly in heavily unionized industries. Moreover, research shows that unions depress long-run compensation for their members by reducing firm innovation and investments.

Unions have considerable market power in collective bargaining agreements since they are the sole supplier of labor services to the firm. There are hundreds of studies estimating union wage premia. Lewis's survey (1986) finds estimated premia around 15-20 percent, meaning that union market power drives up compensation by 15-20 percent over the estimated free market compensation level. More recently, Farber et al. (2018), which include many references, also report similar union premia estimates.

One way this wage premium depresses economic activity is by raising employer costs. This in turn raises prices and reduces customer demand. Moreover, some of the methods by which unions have generated wage premia, which include strikes, independently depress economic activity. This is because a strike is a tax on investment. By idling a firm's capital stock, a strike, or even the threat of a strike, lowers the expected return to investment, which in turn lowers investment, innovation, and productivity growth. This has very negative consequences for the long-run health of the firm, and ironically, for the long-run health of the union.

Alder et al. (2019) analyze the impact of strike behavior and provide both theoretical arguments and empirical evidence that the frequent use of strikes and strike threats in major Rust Belt industries, such as autos and steel is the main factor responsible for the Rust Belt's long-run economic decline.

The Rust Belt, which is typically defined as states bordering the Great Lakes, including Ohio, Pennsylvania, Michigan, Illinois, and New York, accounted for more than 50 percent of the nation's manufacturing employment in 1950. That share declining chronically throughout the 1950, 1960s, and 1970s, until it has fallen to about 38 percent by 1980. This decline preceded the large shift to globalization that began around the mid-1980s, and that is widely believed to have negatively affected U.S. manufacturing. However, the timing of the Rust Belt's decline means that

Alder et al. (2019) find that the historical use of the strike threat by Rust Belt unions accounts for about 2/3 of the decline of the Rust Belt's manufacturing employment share. They also find that it accounts for much of the Rust Belt's failure to innovate at the same rate as non-Rust Belt producers.

Their most striking conclusion is that in the absence of labor market conflict with unions, the Rust Belt's manufacturing employment share would have held steady at about 51 percent, even with stronger foreign competition. This is because globalization doesn't just replace domestic sales with imports but provides opportunities for competitive domestic producers to sell abroad, thus creating new markets.

Schmitz (2002, 2005) studies how union work rules that severely limit the tasks that employees can perform in order to increase employment can depress worker productivity by 50 percent or more. These work rules can be as restrictive as not allowing a worker to perform minor maintenance on a machine, or change a light bulb. He shows that when iron ore producers were subjected to increased competition, union work rules were reformed to permit workers to perform more tasks, which doubled worker productivity.

Similarly, Holmes (1998) studies job creation and economic performance right at state borders, in which one state is relatively heavily unionized, and the state just across the border is a "right to work" state, which outlaws the union shop. He finds that employment growth over time is much higher in manufacturing plants in the right to work states very close to the border, than in manufacturing plants that are close to the border in the heavily unionized states.

Union representation among private sector workers has declined from a high of about 35 percent in the early 1950s, to only around six percent today. This likely reflects several economic shifts since World War II that have led today's workers to find union representation less attractive.

Perhaps the most important factor is changes in competition. As described above, yesteryear's unions imposed significant economic inefficiencies within bargaining at a time when many United States producers faced little competition, either domestically or internationally. But in today's increasingly competitive marketplace, any form of inefficiency threatens firm survival.

A second reason why union organization is much less popular today is that collective bargaining agreements invariably offer a "one-size fits all" compensation package for its members. But as workers have become increasingly skilled, and as job responsibilities have become much more specialized, collective bargaining has become outdated.

The fact that private sector workers are not choosing union representation is the strongest evidence in supporting the view that the union model of yesteryear is not sufficiently valued by today's private sector workers.

Private sector unions have responded to these long-run trends driven by substantially changing bargaining practices to focus on forming cooperative relationships with management and enhancing firm efficiency and performance to increase competitiveness. As an example of this change in union practices, former UAW President Robert King summarized the very significant changes in United Auto Worker practices as follows (see Walsh (2010)):

"The 20th-century UAW fell into a pattern with our employers where we saw each other as adversaries rather than partners. Mistrust became embedded in our relations...this hindered the full use of the talents of our members and promoted a litigious and time-consuming grievance culture."

These long-run changes in private sector unionization density and bargaining practices are natural reactions to increasingly competitive markets, and they are generally improving labor market function by reducing inefficiencies.

The Inefficiency of Occupational Licensing

Licensing occupational practices by a professional bureau has been employed for many years in skilled professions where there is potential for substantial consumer harm. These practices include medicine, law, and dentistry. Licensing is intended to protect consumers by providing objective, third-party confirmation that a provider is professionally qualified to perform their trade.

More recently, professional licensing has spread to many other occupations, particularly occupations where potential consumer damage is extremely modest, such as tour guides, cashiers, card dealers, florists, interior decorators, and hair shampooers. Licensing even extends to professions that are as much or more about providing entertainment as providing a service, such as Maryland, which requires licenses for fortune tellers, and Arizona, which requires licenses for rainmakers. (See Kleiner (2000)).

Today, 29 percent of workers require a professional license, which is up from 18 percent in 2000, and from about five percent in the 1950s. Put differently, this means that nearly 1 out of 3 workers must have government approval to work in their chosen profession.

Most research analyzing occupational licensing has concluded that much of this licensing is not in the interest of protecting consumers, but rather exists to insulate incumbent producers from competition at the expense of consumers.

Licensing limits entry of new professionals, which in turn reduces competition in the industry. Licensing fees also raise the cost of doing business. Both these factors drive up prices, thus reducing demand and harming consumers. Kleiner (2000) finds that wage premia as high as 30 percent due to restricting entry.

Ironically, licensing can also harm incumbent licensees once political and social pressure builds to force regulators to allow reforms. For example, In New York, livery drivers, particularly tax drivers, required a taxi medallion, which simply gave a driver the legal right to operate. Before the popularity of ridesharing, including Uber and Lyft, the market price of these medallions was as high as $1,000,000.

However, this price has now fallen to about $100,000, given the introduction of competition from Uber and Lyft. Tragically, this decline in the price of medallions has led to the loss of virtually all of the wealth of some drivers, who purchased their medallions at very high prices. This in turn has led some of these drivers to take their own lives.

Occupational licensing has also been found to negatively impact historically disadvantaged groups by imposing long training and/or internship periods. (see Gittelman et al. (2018)). For example, over 1700 hours of training are required to become a licensed cosmetologist in California, while 4,000 of training are required to work with electrical signs in Michigan. Note that this latter requirement may exceed the number of hours used by law students in taking classes, studying, and preparing for the bar exam.

The negative impacts of occupational licensing led then President Obama to commission a special study of this issue by his Council of Economics Advisors and the Treasury Department. They concluded the following:

"…the current licensing regime in the United States also creates substantial costs, and often the requirements for obtaining a license are not in sync with the skills needed for the job. There is evidence that licensing requirements raise the price of goods and services, restrict employment opportunities, and make it more difficult for workers to take their skills across State lines. Too often, policymakers do not carefully weigh these costs and benefits when making decisions about whether or how to regulate a profession through licensing."

Summary and Conclusion

This study has summarized research on how economic freedom affects the labor market. Research shows that high tax rates, high regulations, including occupational licensing, inefficient unionization bargaining practices, and high minimum wages, depresses the efficient functioning of the labor market. It also shows that many of these policies have benefits for very few, while imposing significant costs on the rest of society.

The research cited here has important implications for economic policies. It shows that policy reforms that reduce tax rates and eliminates burdensome regulations, and that enhances competition, can significantly increase economic growth and job creation. Moreover, the increased economic growth would dwarf the costs to those who currently benefit from the inefficient policies. This means that those who would lose from such reforms could in principle be easily compensated in the form of income support and job retraining.

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MAKING THE CASE FOR LIBERTY

Prepared for the January 2020
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Hoover Institution, Stanford University

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According to many economists and pundits, we are living under the dominion of Milton Friedman's free market, neoliberal worldview. Such is the claim of the recent book, *The Economists' Hour* by Binyamin Applebaum. He blames the policy prescriptions of free-market economists for slower growth, inequality, and declining life expectancy. The most important figure in this seemingly disastrous intellectual revolution? "Milton Friedman, an elfin libertarian…Friedman offered an appealingly simple answer for the nation's problems: Government should get out of the way."

A similar judgment is delivered in a recent article in the Boston Review by Suresh Naidu, Dani Rodrik, and Gabriel Zucman:

> Leading economists such as Friedrich Hayek and Milton Friedman were among the founders of the Mont Pelerin Society, the influential group of intellectuals whose advocacy of markets and hostility to government intervention proved highly effective in reshaping the policy landscape after 1980. Deregulation, financialization, dismantling of the welfare state, deinstitutionalization of labor markets, reduction in corporate and progressive taxation, and the pursuit of hyper-globalization—the culprits behind rising inequalities—all seem to be rooted in conventional economic doctrines.

A recent essay from Larry Kramer, President of the Hewlett Foundation and former dean of the Stanford Law School, makes similar claims and blames Friedman, Hayek, and the Mont Pelerin Society for laying the groundwork for a free-market policy revolution:

> Unfortunately, today's prevailing intellectual paradigm — which has come to be labeled "neoliberalism" — is no longer up to the task. However well this free market orthodoxy suited the late 20th century, when it achieved broad acceptance, it has proved unable to provide satisfactory answers to problems like wealth inequality, wage stagnation, economic dislocation due to globalization, and loss of jobs and economic security due to technology and automation.

Based on these quotes, you'd think we were living in a world where free-market policies dominate, where government keeps getting smaller and where individual liberty is on the rise, a world in other words, with a "broad acceptance" of "free market orthodoxy.

I see the glass as very much half-empty. Or maybe even a lower level.

The nanny state continues to grow. The size of government continues to grow. Crony capitalism seems to get cronier every year. Socialism is back on the table in a serious way that it never was before in the United States. There is a relentless focus on inequality from economists on the left and politicians who have accepted their claims. That capitalism serves only the richest among us has become a mainstream consensus. Economic nationalism and protectionism are on the rise. Occupational licensing is increasingly common. And while some markets have been deregulated, the commanding heights of the modern economy—health, education, housing, and finance are increasingly distorted by government intervention.

If this is a free-market triumph, give me less of it.

The bottom line is that those of us who care about economic freedom and the classical liberal values of Adam Smith, Hayek and Friedman that emphasize the freedom to choose—we are very much on the defensive. We have lost the moral high ground as well as our footing in the public discourse on these issues. We are increasingly ignored.

In this essay I'd like to make a few suggestions on how we might make some headway in making the case for liberty and for making a move away from growing government more likely rather than less.

What About the Poor?

Free-market economists tend to focus on growth. I'm a big fan of growth. I think a rising tide still lifts most boats. I think people continue to risk their lives to come here to be poor because they believe they will thrive here and their children will thrive. The guards in Cuba face inward not outward—they don't have to keep out Americans seeking an egalitarian paradise. They have to keep Cubans in who wish to escape.

Through videos I've created at the PolicyEd.org website in my series called The Numbers Game and elsewhere, I've tried to make the case that the claim that the top 1% or the rich or even the top half of the income distribution have captured all the gains from economic growth over recent decades ignores evidence that shows that the gains from economic growth are still widely shared.

But even if a rising tides lifts most boats, it still seems like many boats are indeed being left behind over the last few decades.

Those who did not finish high school, those who finish high school but did not go to college, former manufacturing workers, single men, even, all seem to be having a tough time if not a tougher time than they did in the past.

The standard policies that free-marketers favor don't do much for these groups. Reducing the size of government, lowering tax rates, reducing poorly designed regulation, removing barriers to free trade—these policies seem unlikely to help the least likely among us. And our opponents would argue that they would make things worse.

I think these are good policies. But I don't think they would do a lot for the worst off in America's cities, the people struggling with opioid addiction in parts of America that no longer have much opportunity for men without a college degree or just generally people with low educational attainment.

When interventionists claim that inequality is destroying the fabric of the American economy and our political system, it is not enough to say that capitalism still works well. At least on the surface, it doesn't seem to be that helpful to the groups I mentioned earlier.

Regardless of whether smaller government and more economic freedom would help poor Americans, how often do you hear free market economists argue on behalf of smaller government on the grounds that it is good for the poor? In the 1970s and 1980s, free-market economists regularly advocated for policies like urban enterprise zones that would help the poor. You can argue that those were not a good idea. But I think the attentions of the advocates were honorable. When was the last time you heard an economist make the case that free markets are good for poor people? How would you make the case that someone without a college degree is helped by any of the standard policies that free-market advocates frequently speak about?

I worry that part of our silence comes from a self-satisfied myopia. In America today, there is still enough liberty for my children to acquire skills, to dream, and to thrive, finding opportunity and using their gifts and skills to flourish. For many of us, America is "free enough." You can still start a company or create a product that is transformative. You can raise money from venture capitalists. Or you can go out and get a STEM degree and work for the companies that entrepreneurs can start in America and live very well. I don't think we can say the same thing for children growing up in poor households. America is not free enough for them. It is those children and the adult lives they will lead who we should use to make the case for freedom.

When I attend conference dinners with free-market speakers, I often think about the wait staff who often are in the room waiting for the speaker to finish so they can serve the meal or clear the tables. What is in that speech for them? Is there something in speaker's message that resonates with their lives. If not, we are failing to make the case for freedom.

At a minimum, I think it is important that we emphasize the harm that comes from various interventionist policies and in particular how that harm is borne by the least fortunate among us.

Classical liberals need to advocate for repealing the rise in occupational licensing that makes it hard for those with little education to be part of the modern economy. We need to fight against zoning and other land use restrictions that push poor people out of cities and away from the economic opportunity in those cities. Those same restrictions make it hard for workers in towns that have lost factories and other economic activities to move more easily to cities with more opportunity. We need to advocate for radical reform of the schools that the poorest Americans attend. They do not serve the poor very well.

Of course, most if not all free-marketers favor these policies to help the poor. But they are usually not at the top of the list of policies free-marketers are passionate about.

Growth is probably a good thing. But to advocate for policies that lead to growth or to argue for policies that are "good for the economy" without discussing their impact on those at the bottom of the income distribution is to cede the moral high ground to our ideological opponents.

So I would suggest on both rhetorical and moral grounds that we focus on the poor and the least fortunate when we make the case for smaller government.

Have a Plan

My second suggestion is that we do more than criticize interventionist policy we don't like. I think our current health care system is a disaster. We subsidize demand while restricting supply of providers like doctors and hospitals. We make competition among hospitals difficult. This system provides excellent care most of the time to seniors, employees of large corporations, and the poor. For others, the cost is extremely high. And while the quality is high for those who are subsidized, it's not clear that the value provided is worth the cost. It's hard to say because so few people are spending their own money. The result is a Kafkaesque labyrinthine system with fake prices, and few if any of the feedback loops that make markets work well.

So what should replace this disaster? I would like to see us move in the direction of increasing the role of market forces in health care—an expansion of health savings accounts, eliminating certificates of need for new hospitals to open, encouraging the role of generics in prescriptions, increasing the potential role of nurses in providing basic health care. I am encouraged by the potential of the idea of mandating more price transparency although I am always a little uneasy about attempts to mimic markets through legislation rather than having such features emerge via competition.

But is this grab bag the best approach? Should everything else be left in place? Even now, in the current system there are a number of people taking initiative to get around the horrible system we have. This would include the Surgery Center of Oklahoma, various so-called blue-collar concierge practices, and clinics for the poor outside of the traditional channels of provision. Should we just hope that these expand? What about the Affordable Care Act? Should it be left in place or replaced?

I don't know of a comprehensive free market approach to health care other than simply saying we should get government out of the health care business or at least dramatically reduce its role. John Taylor can tell us how he'd like to see the Fed behave—he'd like the Fed to follow the Taylor rule. What's the equivalent policy prescription in health care? How does a free-market advocate respond to the worries about Big Tech? What policies should replace the current zoning and land use regulations in American cities? What policies should be in place to replace bailouts when the next financial crisis arrives.

I am not saying that plans or proposals to deal with those issues don't exist. They may be out there. But they don't have any traction in the public eye or even among economists or policy analysts. We need to do a better job providing a road map for free-market policies. It's not enough to explain what's wrong with the current system.

Don't Defend Cronies

If we're going to reclaim the moral high ground and make progress fighting for liberty, we should stop defending cronies who benefit from crony capitalism. Yes, the left hates the financial sector and finance. But sometimes the left is right. I've heard free-market economists defend the financial sector's accepting of bailouts as a simple case of self-interest and profit-maximization.

The defense goes something like this: "You can't blame financial institutions for their behavior during the housing crisis and the financial crisis that followed. They were just responding to the incentives put in place by government." Sort of. First, not everything self-self-interested is moral. This is a fundamental error that our students often make. Just because it can be in your self-interest to keep a wallet that you've found as long as no one sees you pick it up doesn't mean it's moral to ignore looking for the previous owner.

But the bigger problem with the argument defending the financial sector is that investment banks are often more than passive responders to incentives. They create the incentives. They influence the regulators. They influence the people who write the regulations. They make the case for bailouts claiming the world will end if they do not get 100 cents back on the dollar. They are part of the problem. They are not pristine capitalists.

A similar mistake gets made in discussing the pharmaceutical industry. I have heard economists defend their price increases because after all, that is what the market will bear. That market is distorted by subsidies and barriers to competition that the industry has helped put in place. The pharmaceutical industry has delivered benefits to humanity through the profit motive. I'm a big fan of the profit motive. Many on the left feel that profits should not be part of medicine. I think that's fundamentally wrong. But the world of pharmaceutical pricing is not a market in any normal sense of the word. Not because there are patents. But because most consumers of pharmaceutical products are not paying with their own money. The third-parties that pay for those products often have very little skin in the game. Big Pharma is not some evil villain. But many of the practices of Big Pharma should not be defended. And certainly the system that creates the incentives should not be defended.

The feedback loops in finance and medicine have been broken partly through the lobbying efforts of the players in those industries. Other problems persist because of the unintended consequences of various interventions. This is not free-market capitalism. We who support free markets should not pretend it is simply because our more interventionist friends don’t like those players. We shouldn’t like them either. The enemy of our enemy is not always our friend.

Flourishing and Dignity Cannot be Found in a Spreadsheet

My final suggestion is that we remember as economists and thinkers that there is more to life than what can be measured. The true value of liberty is to create the potential for each of us to pursue our dreams using our skills. The result is more than just a high standard of living. It is the opportunity for human flourishing. Human flourishing is about much more than financial well-being. It is about agency, and pride, and dignity.

None of these central human urges can be measured or put in a spreadsheet. When I tell economists this, they usually say things like, sure, I can’t put that into say, a cost-benefit analysis. So we look at what can be measured and use that as best we can to evaluate a policy relative to the intangibles.

That is all well and good. In my experience, we then just forget about the intangibles. This seems to be a natural human impulse. I urge us to fight against it. Remember the intangibles.

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Roberts’s poem and animated video “It’s a Wonderful Loaf” (wonderfulloaf.org) is an ode to emergent order. His series on the challenges of using data to measure economic progress, *The Numbers Game*, can be found at PolicyEd.org. His latest book is *Gambling with Other People’s Money: How Perverse Incentives Caused the Financial Crisis* (Hoover Institution Press, 2019).

Other books include *How Adam Smith Can Change Your Life: An Unexpected Guide to Human Nature and Happiness* and *The Choice: A Fable of Free Trade and Protectionism*, which was named one of the top ten books of 1994 by *Businessweek* and one of the best books of the year by the *Financial Times*. Roberts holds a PhD in economics from the University of Chicago and received his undergraduate degree in economics from the University of North Carolina at Chapel Hill.

Brexit: Taking a Good Idea into Action

Lord Borwick

Delivered at Mont Pelerin Society Session: Taking Ideas to Action in Central Governments

17 January 2020

It's an honour to be here on the 40th anniversary of the last Mont Pelerin meeting at Hoover. Back then, Margaret Thatcher had just come to power in the UK and was about to embark on a great programme of reform, freeing up the economy from the dead hand of the state. Now, we in the UK are experiencing the thrill of another push for freedom: Brexit.

This session is about taking ideas into action, and my focus will be on Brexit. As you know, there has been a little difficulty implementing it, but we are getting there… The first thing to say is that Brexit is a great idea - so great, in fact, that it was invented by the American founding fathers.

After all, many of the founding fathers were freeborn Englishmen, fighting George III, a German king, with his Hessian army. A familiar battle between the English and the Germans, then. With a familiar result...

That separation was very good for America, of course. So there are reasons to be very excited about Brexit. After all, we should remember that spinoffs tend to outperform the market, largely due to the freedom to innovate and streamline. We can set our own standards, our own rules. We can thrive - maintaining a safe distance from the inevitable decline of the Euro.

But what was the original idea of the EU? Of course, it all started with Jean Monnet and the European Coal and Steel Community. To introduce free trade in resources. To tie together the perpetually feuding nations of Europe and avert future conflict, they pretended. The idea actually was that the world needed a European superstate, to hold the balance of power between the American superstate and the Soviet superstate. The later collapse of the Soviets didn't seem to change their argument.

But overall, the idea was to develop a superstate under cover of a free trade block. Which might, at the time, have seemed appealing to many Brits - because we were the victims of a bad idea ourselves. That of 'managed decline' - that Britain was on a downward slope from empire to ignominy, and the greatest ambition of any Prime Minister was to slow this down. Only Margaret Thatcher had the will, and the policies, to change direction.

But before her, to slow managed decline was the main reason we joined the European Economic Community in 1975.

Throughout our membership, the argument went that the loss of national political control is always a price worth paying for overall economic gain. That was what we were led to believe when Britain signed up to the Common Market in the first place. And even Margaret Thatcher signed up for further integration in 1986, when the EEC changed into the EU. She was persuaded that some independence would be lost but decided that the economic gain – and the benefits that would bring people in the UK – would outweigh those losses.

Boris Johnson called this ‘the Faustian pact of the EU’ – surrendering something precious in the form of national autonomy to make everyone richer. But we know that Faust was eventually dragged off to hell…

So it’s perhaps unsurprising that growing for many decades since has been the idea of leaving the European Union. And great ideas have many fathers, many parents, but chief among them must be our fellow member Dan Hannan MEP, a member of the European Parliament for another fortnight only. It was Dan who wrote about Brexit, spoke about it, pushed it and pulled it, and grew the Eurosceptic movement until David Cameron called a referendum to shut down his argument.

Cameron’s advisors never really considered the possibility of Brexit happening. It seemed that their purpose was to scare the public into thinking that Brexit would be a disaster. Certainly Boris, who worked in Brussels as a journalist for some years, saw first-hand the democratic deficit at the heart of the EU project. And perhaps such exposure allowed him to see more clearly than others that Brexit could be an opportunity.

Many Conservatives on the Remain side of the debate didn’t really see Brexit as an idea at all - they saw it as something that was affecting votes, as Conservative members fled to the United Kingdom Independence Party, led by Nigel Farage. So a referendum was called stem the flow. It was electoral calculus - tactics, not strategy.

Boris may have had a relatively privileged upbringing, but in his work he met and discussed with people, who had different perspectives on things. He learned, and was challenged. He famously wrote two articles before openly joining the Vote Leave campaign. One was for Remain - which was never published. The other for Leave - which was. I think it shows Boris was trying to frame his choice as the best idea.

And running the Vote Leave machine was a man called Dominic Cummings - someone so intriguing in the Brexit debate that Hollywood star Benedict Cumberbatch played him in ‘The Uncivil War’, a TV movie about the campaign. He was employed to deliver Brexit - and he did the job. His big idea was perhaps the most effective slogan in British campaigning history.

‘Take Back Control’. Genius in its simplicity. Active, not passive.

We should remember that the Brexit vote was the biggest vote for anything, ever, in the UK. As you all know, Cameron resigned and a new Prime Minister was chosen in Theresa May. And Boris Johnson replaced May last summer, and has just won a resounding Election victory. Resounding enough to finally deliver Brexit with no Parliamentary drama. I think this proves something about great ideas. A great idea needs a great champion, or it fails.

Peter Boettke wrote about this in his paper for his session yesterday - Milton Friedman was astonishingly brilliant at delivering the ideas of economic freedom. It’s a similar story with Brexit - Boris is very good at carrying and explaining ideas. And given this session is about taking ideas into central government, there is another key point that must be stressed.

We must continue to campaign for a good idea, even after it wins.

After the Brexit vote in 2016, it was assumed that it would be delivered. So the Brexiteers, exhausted by the referendum campaign, understandably stepped back. During the campaign, the Remain side argued that Brexit would cause the collapse of the British economy - what was known as Project Fear. And even after they had lost, they stayed organised and campaigned hard. And given the civil service did not generally believe in Brexit, as well as most MPs and Peers, they all did their best to frustrate it. It nearly worked, too.

So to action good ideas, we must continue to talk about why they are good, even when they are government policy and we think the battle has been won.

And with Brexit, there is still some work to do. In the next 11 months we have to negotiate the trade deal with the EU, and many of our remain-backing friends are willing for Britain to suffer, to demonstrate the fallacy of our wishes for independence. And, of course, to discourage any other nation from following us out. The EU's opening gambit is that free trade with them requires us to accept all of their regulations, however changed in the future. That's the same as staying in - no taxation or regulation without representation, becomes our cry.

The solution may be to arrange the free trade agreement that is possible with the United States, and do it quickly. That would demonstrate to the EU that we will be fine on our own, and should mean they drop their demands. In any case, a free trade agreement between all the English Speaking Peoples would be a good end to aim for.

Over time, I believe that Brexit may turn into the poster boy for 'ideas into action'. This was an idea that the people wanted, but much of the establishment and the media didn't. Those who defended Remain so vigorously do so in the same way that medieval clerics defended religion. Any discussion of the merits of this heresy was useless. We have had good politicians destroy their political career for this cause. Perhaps this is the modern equivalent of being burnt at the stake.

Indeed, there is an English expression that 'there is nothing more ex than an exMP'. An exMP who lost because of a principle that they couldn't persuade the voters to adopt should be the subject of our pity.

A final note on Boris, too. David Henderson's paper, discussed in yesterday's session, starts with the Thatcher quote 'you must start with beliefs. Yes, always with beliefs'. Beliefs are important, of course. Possessing them gives one the advantage of having an instinct of what to do when a situation changes, or event occurs. So I am excited that we will hear much more from the Prime Minister on his broader vision for the country.

On economics, I hope we allow society to flourish by slimming down the state. Not just in spend to GDP ratios, but more fundamentally in what actions it deems necessary to take. Again, we have a continuing job to do on making the case for less intervention and lower taxes.

I'll finish by saying that Brexit is a good idea; has a good champion in Boris; but that we must continue to make the case even when we think the battle is won.

Thank you.

Taking Ideas to Action in Central Governments

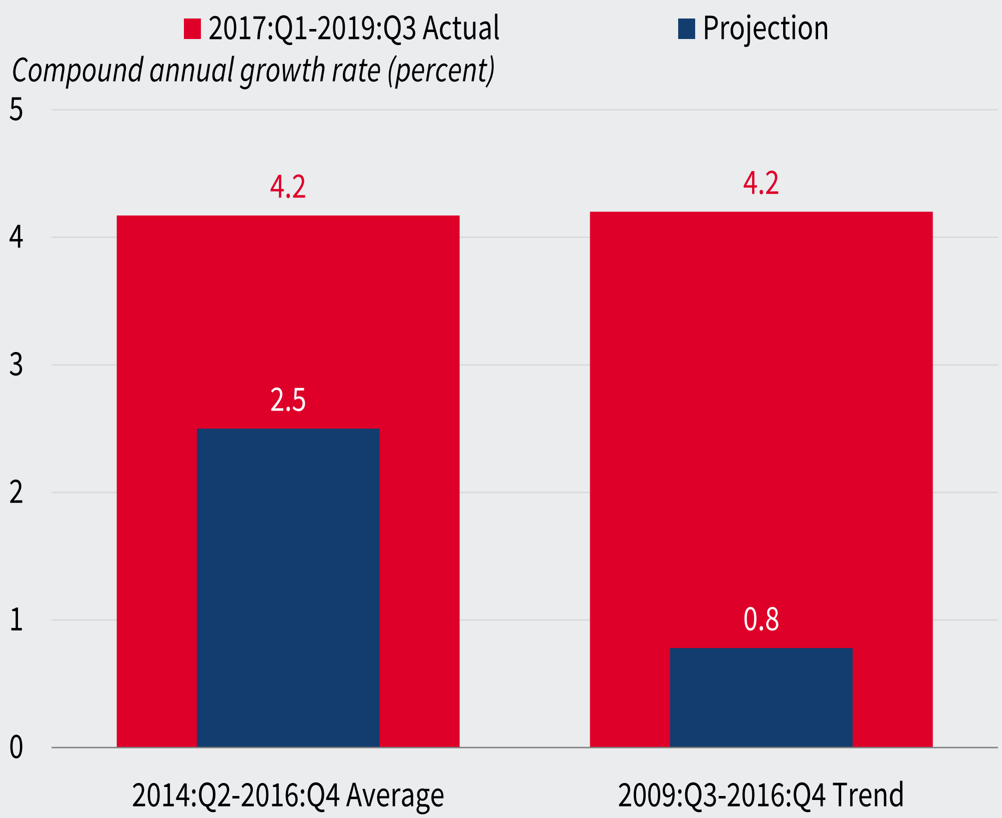
Tyler B. Goodspeed, Council of Economic Advisers *

Mont Pelerin Society, Hoover Institution

January 2020

Investment and capital stock have risen.

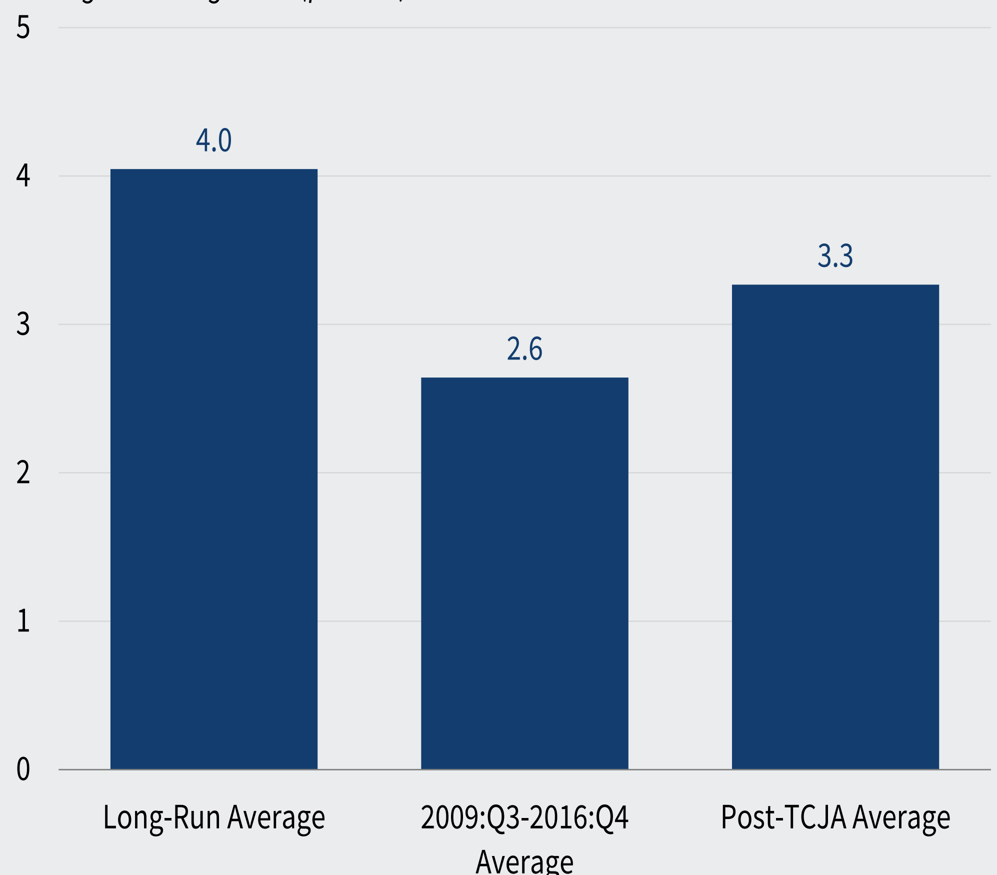
Growth in Real Nonresidential Fixed Investment, 2017:Q1–2019:Q3



Sources: Bureau of Economic Analysis; Council of Economic Advisers, Author's calculations.
Note: The pre-2017 trend is estimated over a sample from 2009:Q3 through 2016:Q4 and projected into 2017-2019.

Growth In Capital Services, 1966–2019

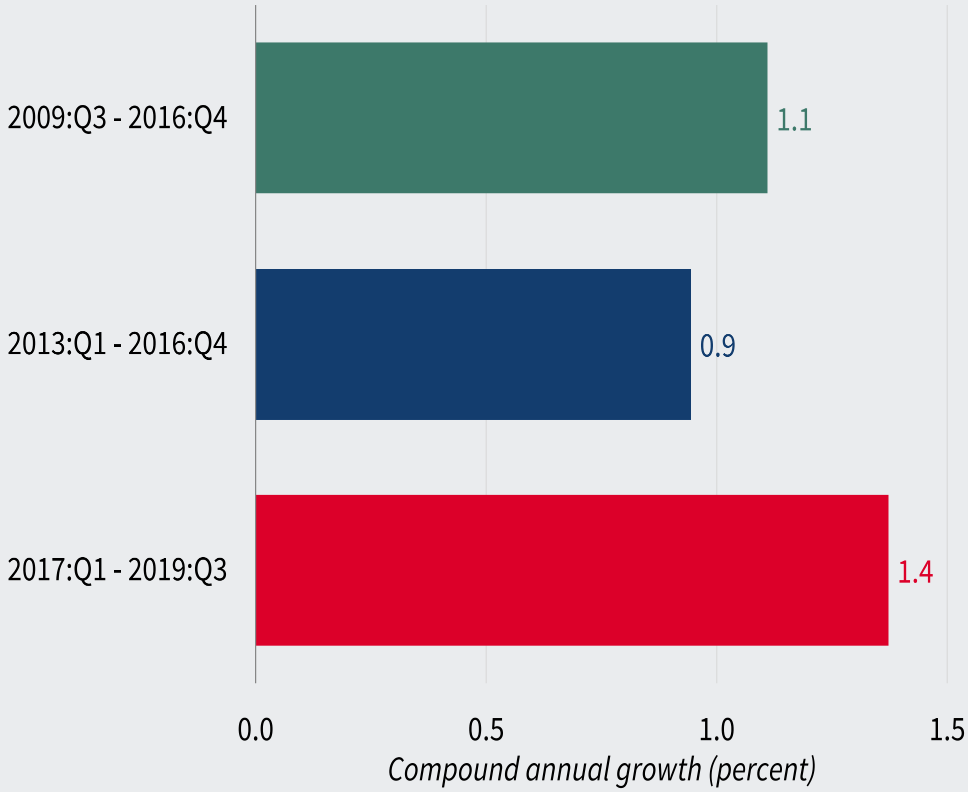
Average annual growth (percent)



Source: IHS Markit, Council of Economic Advisers.

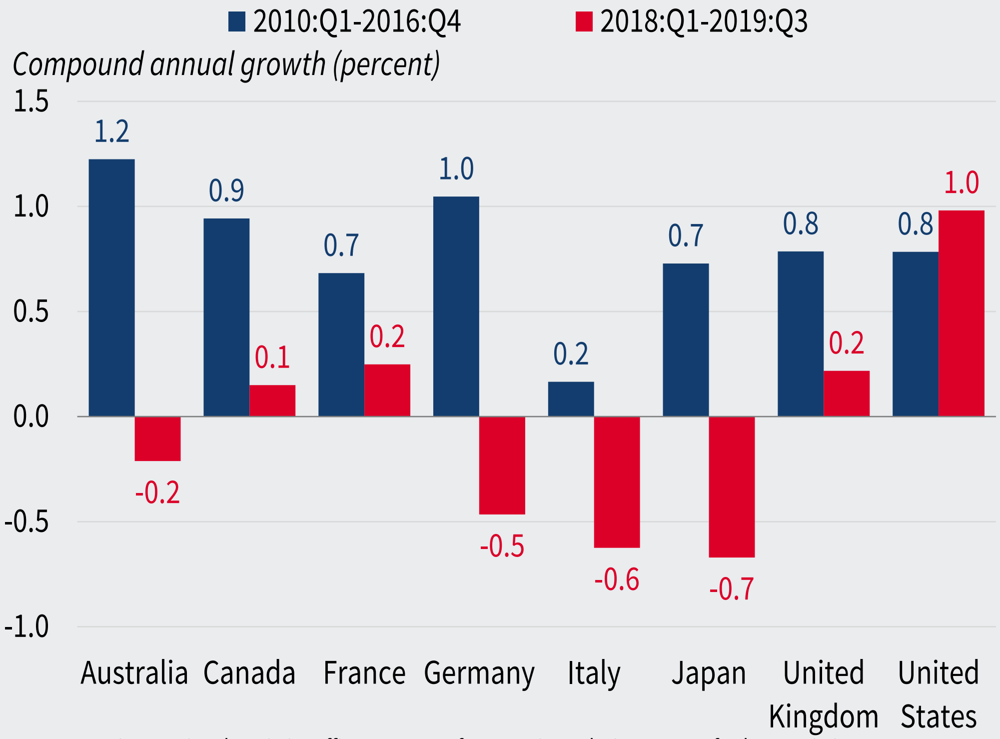
Labor productivity has accelerated.

Nonfarm Business Sector Labor Productivity Growth, 2009–2019



Sources: Bureau of Labor Statistics; Council of Economic Advisers, Author's calculations.
Note: Annual growth rate is calculated for real output per hour of all persons in the nonfarm business sector.

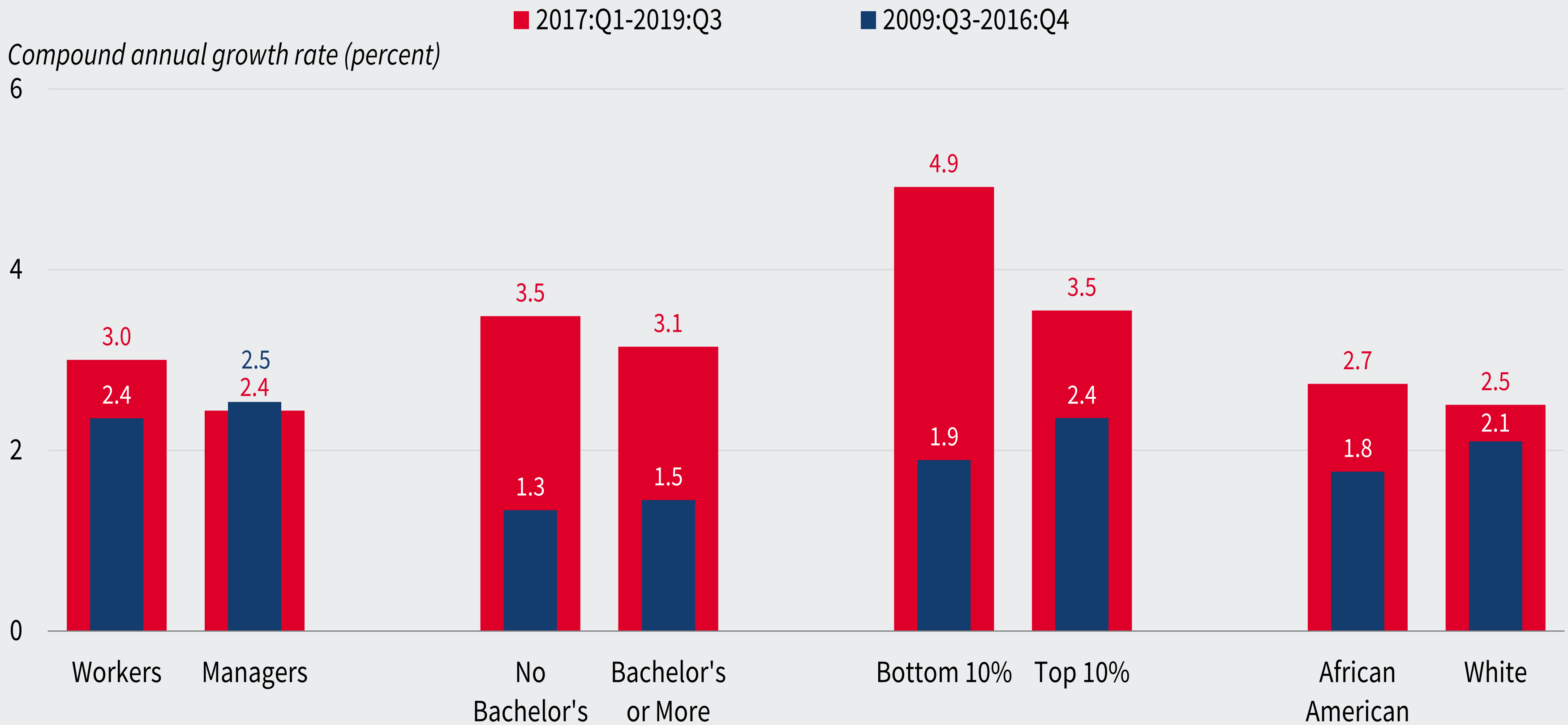
Growth in Real Output per Employed Person Among Advanced Economies, 2010–19



Sources: Various national statistics offices; Bureau of Economic Analysis; Bureau of Labor Statistics; Haver Analytics; Council of Economic Advisers, Author's calculations.
Note: Values represent a compound annual growth rate calculated over the given quarters. Growth rates are based off of real GDP divided by seasonally adjusted employment. Employment includes government employees.

Wage gains concentrated among recently more marginal workers.

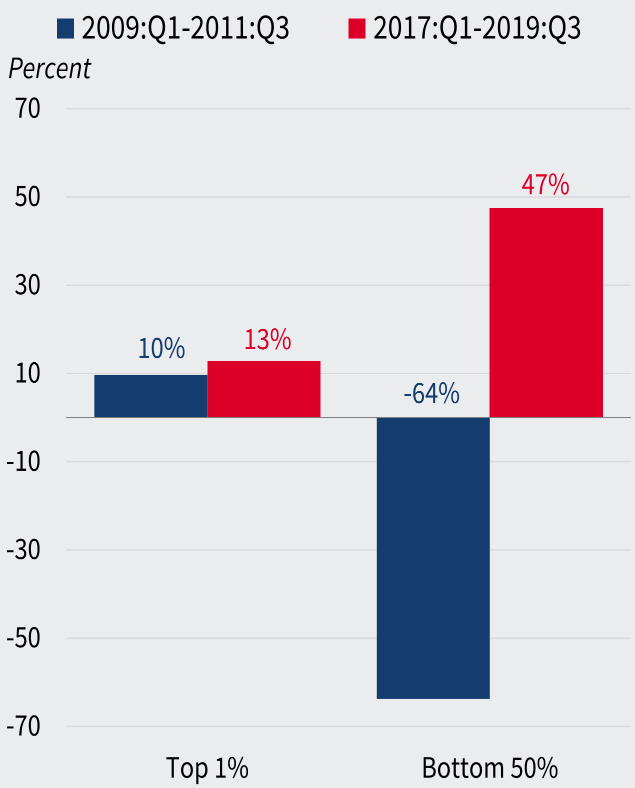
Growth in Earnings, 2009–19



Sources: Bureau of Labor Statistics; Council of Economic Advisers, Author's calculations.
Note: Data represent a compound annual growth rate for 2009:Q3–2016:Q4 or July 2009–December 2016 and 2017:Q1–2019:Q3 or January 2017–November 2019. For workers and managers, earnings are defined as average weekly earnings. For all other categories, earnings are defined as median usual weekly earnings.

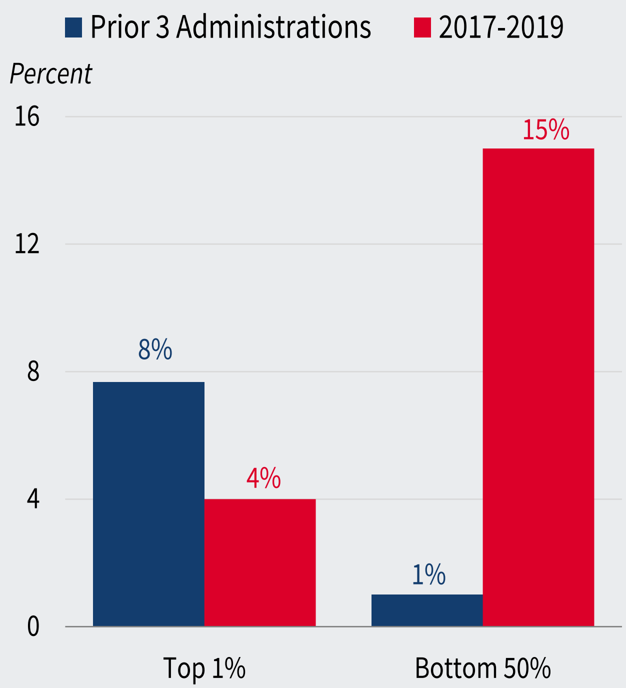
Recent wealth gains higher at lower end of the distribution.

Change in Real Net Worth in the First 11 Quarters



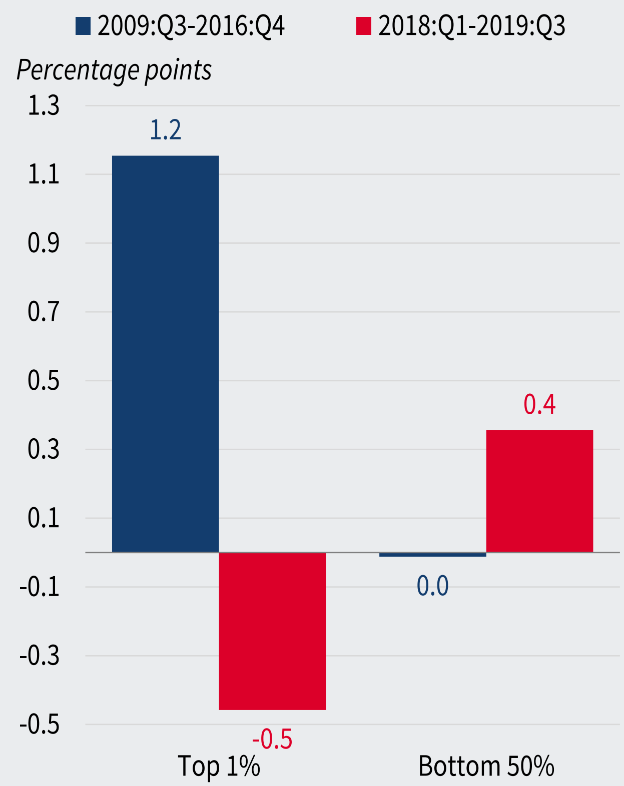
Sources: Federal Reserve, Bureau of Economic Analysis, Council of Economic Advisers, Author's calculations.

Growth in Real Net Worth of the Bottom 50 Percent



Sources: Federal Reserve Board; Bureau of Economic Analysis; Council of Economic Advisers, Author's calculations.
Note: The blue bar represents the average annual growth across previous administrations' expansion periods. The red bar represents annual growth from 2017:Q1 to 2019:Q3.

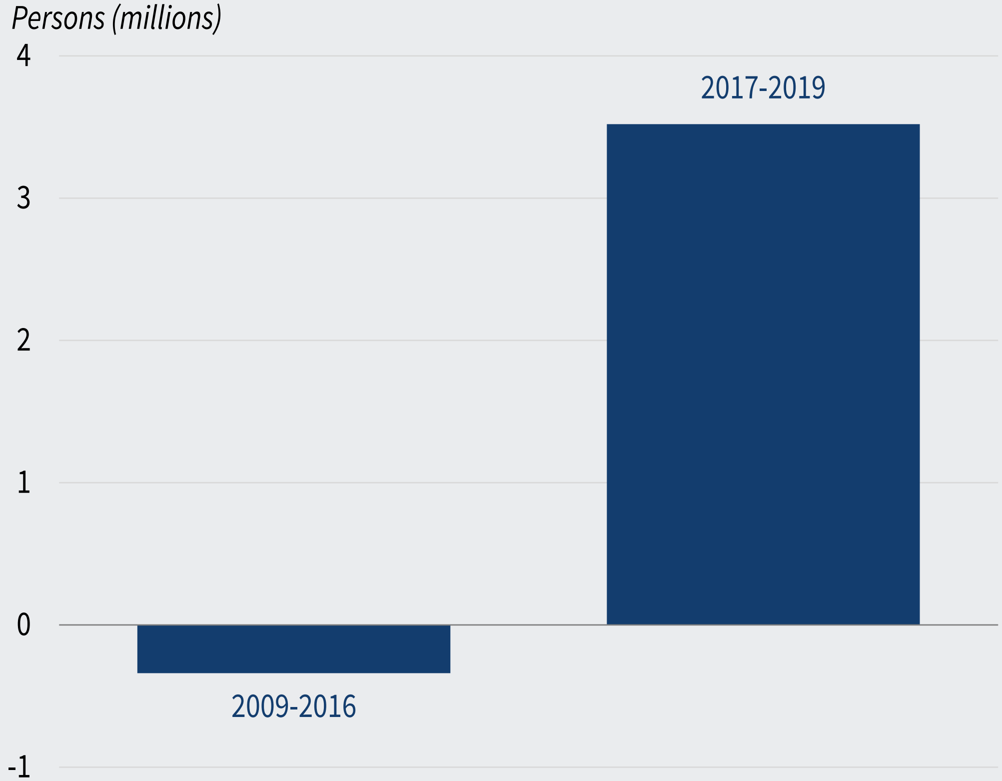
Change in Share of Net Worth, 2009–19



Sources: Federal Reserve, Bureau of Economic Analysis, Council of Economic Advisers, Author's calculations.

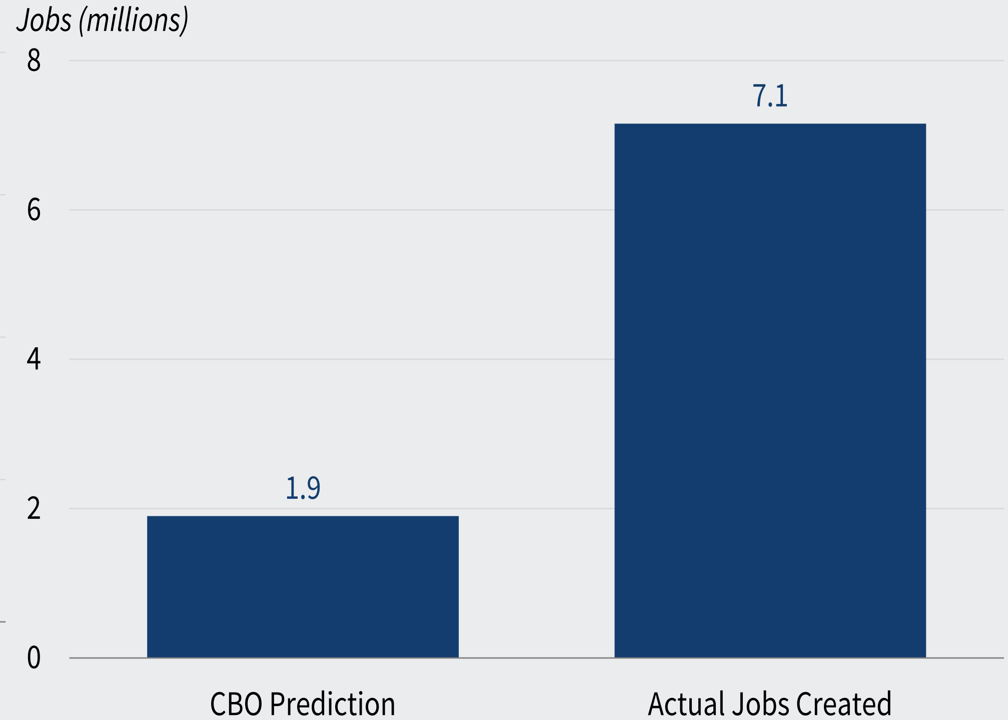
Observed labor market strength exceeds expectations.

Contraction vs. Expansion of Working Age Labor Force, 2009:Q3–19:Q4



Sources: Bureau of Labor Statistics, Council of Economic Advisers, Author's calculations.

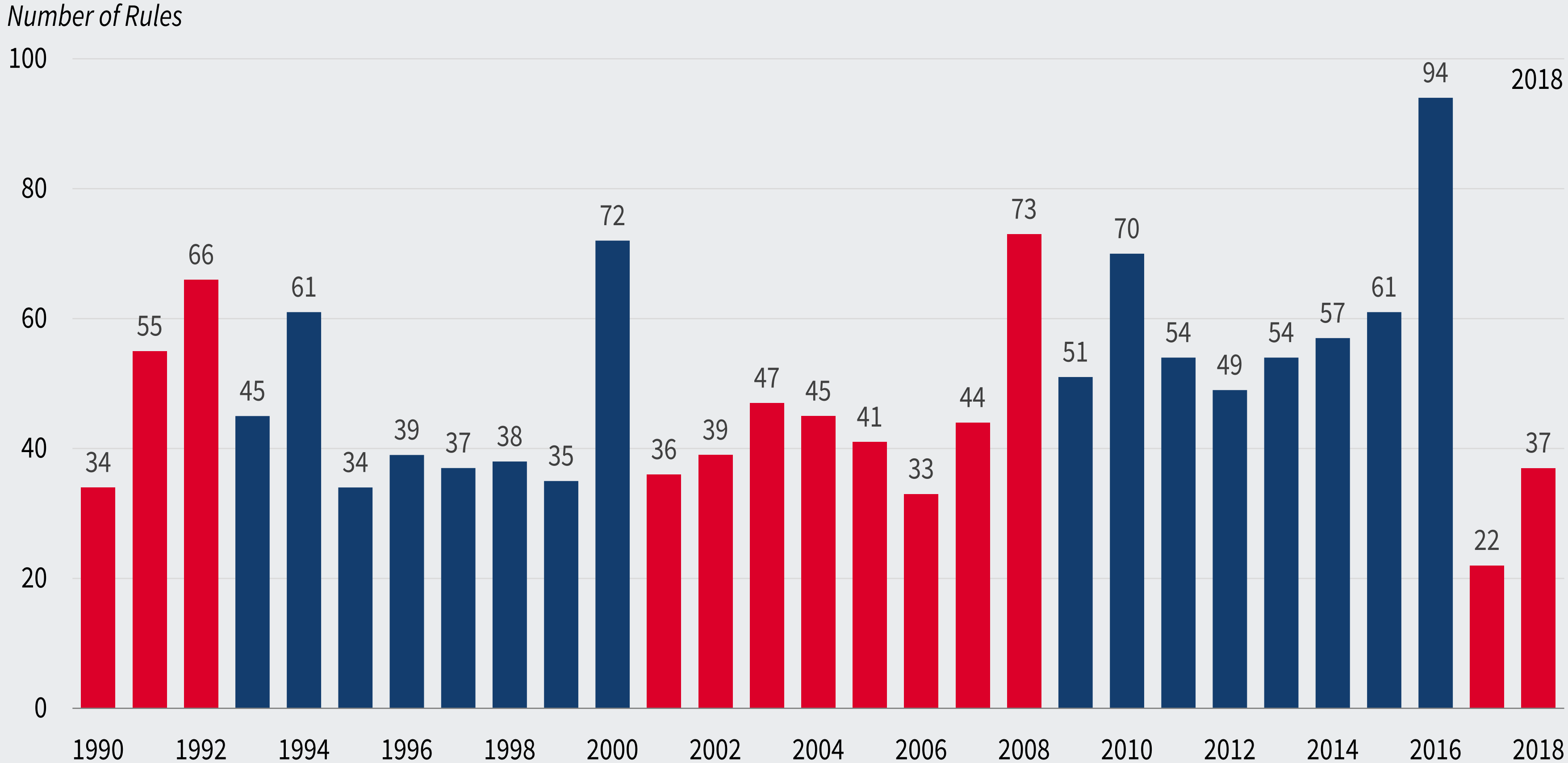
Predicted vs. Actual New Jobs, 2016:Q4–2019:Q4



Sources: Congressional Budget Office, Bureau of Labor Statistics, Council of Economic Advisers, Author's calculations.
Note: CBO projection represents the final pre-election forecast made in August 2016.

Between 1990 and 2016, the Federal government added an average of 50 economically significant regulations each year.

Economically Significant Regulations by Presidential Year, 1990–2018

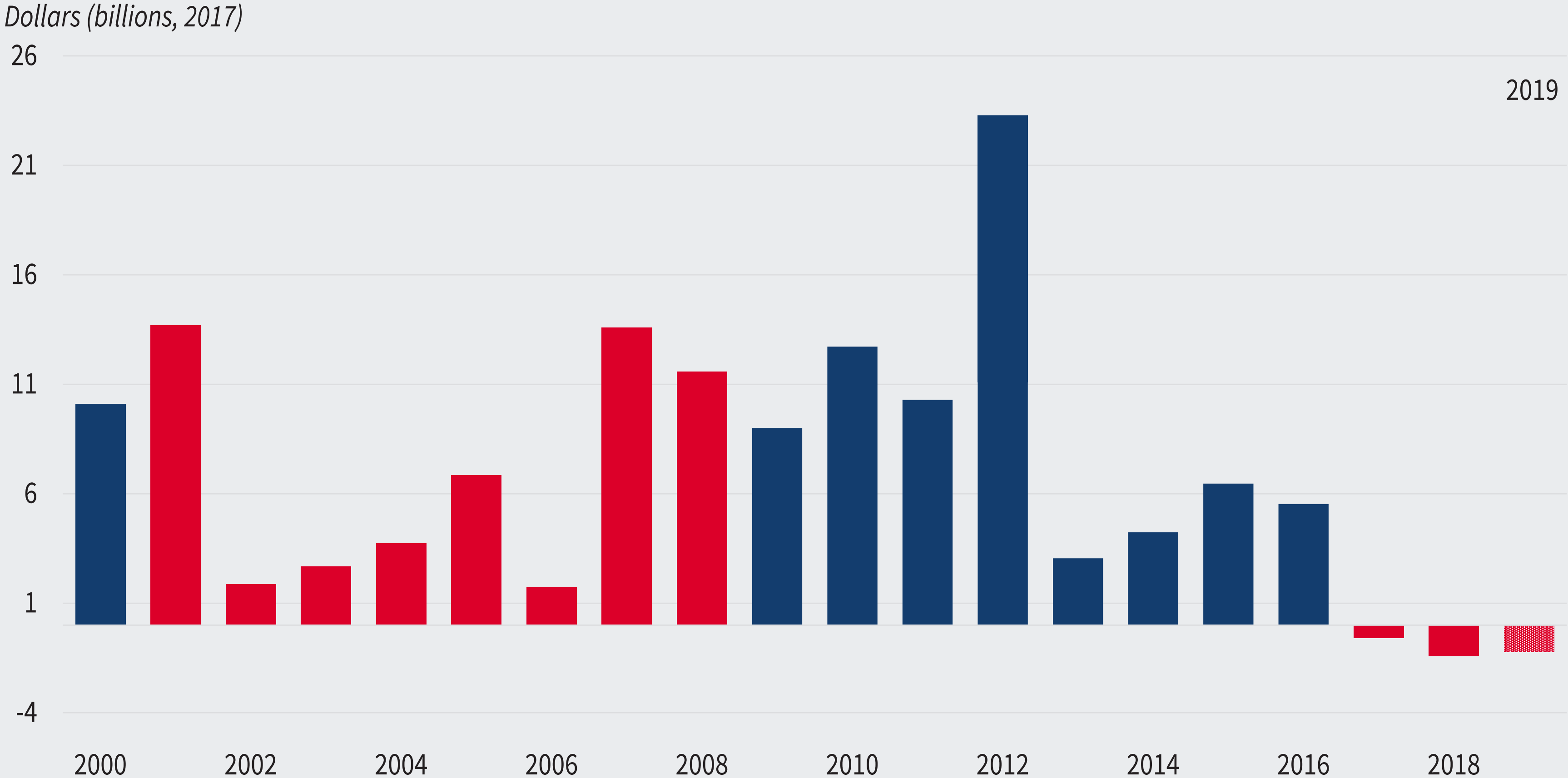


Sources: reginfo.gov; George Washington University Regulatory Studies Center.

Note: Presidential years begin in February and end in January of the following year. The 2018 final rule count is to date as of September 11, 2019. Rule counts for 2017 and 2018 exclude rules considered deregulatory actions. Prior to 2017, we estimate approximately one deregulatory action per year.

New regulations added regulatory costs each year from 2000–2016.

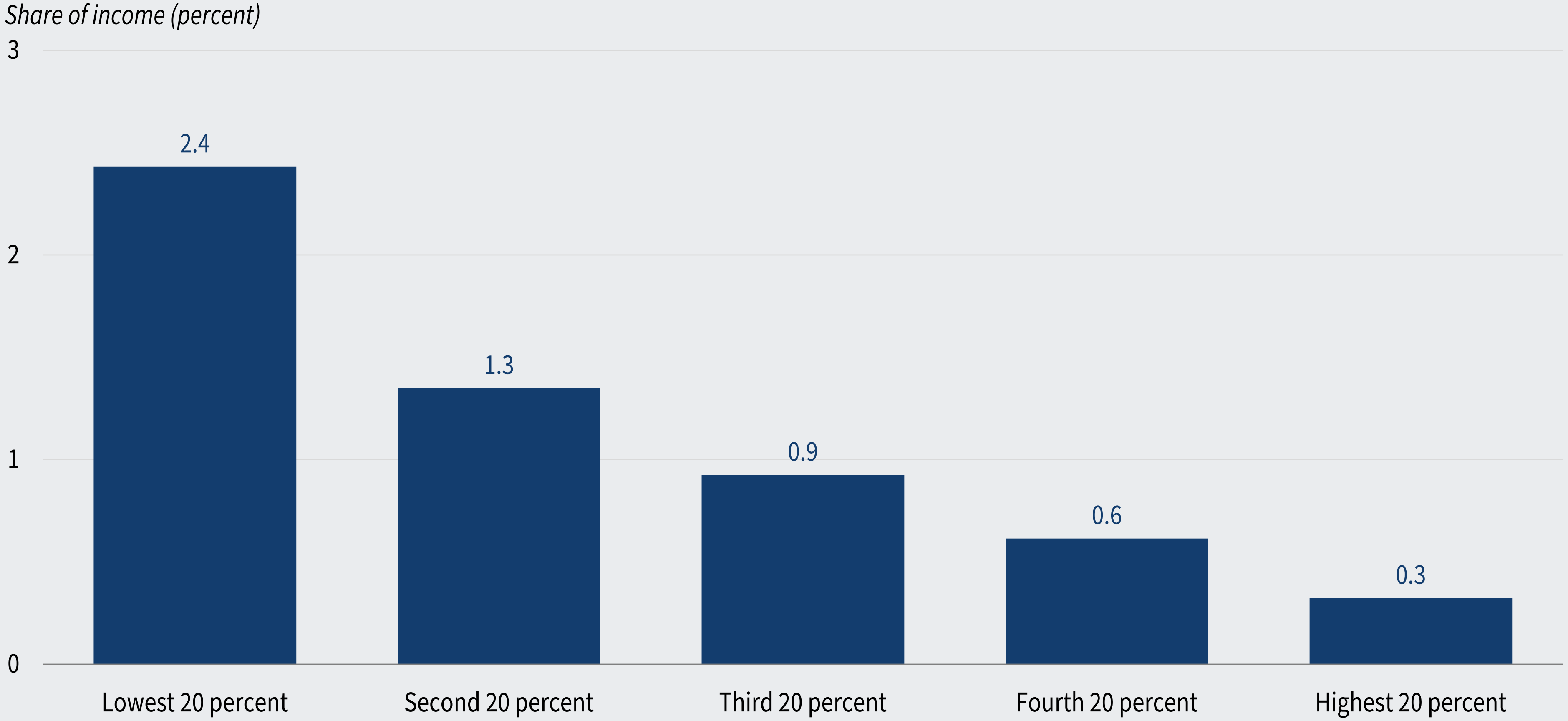
Real Annual Costs of Major Rules, Fiscal Year 2000–19



Sources: *OIRA Reports to Congress*; Council of Economic Advisers.
Note: Calculations based on the cost estimates for years 2000 through 2016 from the most recent *OIRA Report to Congress* with an estimate for that year, combined with the reported annualized regulatory cost savings for 2017-2019. Negative costs indicate cost savings. Annual cost estimates include all major rules for which both benefits and costs have been estimated.

Progressive deregulation.

Consumer Savings on Prescription Drugs and Internet Access by Household Income Quintile



Sources: Bureau of Labor Statistics; Bureau of Economic Analysis; Council of Economic Advisers, Author's calculations.
Note: Values represent CEA's estimates of consumer savings as a share of their income which applied Consumer Expenditure Survey's quintile and expenditure data to national income data.

* Tyler Beck Goodspeed, Council of Economic Advisers. Contact: tyler.goodspeed@alumni.harvard.edu. The views expressed in these remarks and slides are the author's own and do not reflect the views of the Council of Economic Advisers or the Executive Office of the President of the United States.

TYLER GOODSPEED

COUNCIL OF ECONOMIC ADVISERS

Tyler Goodspeed currently serves as a member of the Council of Economic Advisers. He was formerly a junior fellow in Economics at the University of Oxford, and a lecturer in Economics at King's College London. His primary research and teaching fields are economic and financial history, with secondary interests in political economy.

Prior to earning his PhD from Harvard University in 2014, he received his AB from Harvard summa cum laude in 2008 and from 2008 to 2009 was a Gates Scholar at the University of Cambridge. His second book, *Legislating Instability*, examines the effects of unlimited liability and regulatory capture on financial stability in "free banking" Scotland. He also has a recent book, *Famine and Finance*, on the market for small loans during the Great Famine of Ireland, as well as companion articles in the *Journal of Development Economics* and *World Bank Economic Review*.

Goodspeed's current research focuses on eighteenth- and nineteenth-century British and North American economic history, with particular attention to informal banking and the political economy of financial regulation, as well as long-run economic development. In his first book, *Rethinking the Keynesian Revolution*, he analyzed the debates between John Maynard Keynes and Friedrich Hayek, considering the relevance of those debates to contemporary monetary economics.

MPS 2020 @ Stanford

Ideas and Actions for a Free Society

Politicians come in every hue. Some are cause driven, some are conviction driven and some dare I say it are driven only by their own ego.

But because it is a mission of mine to see the vocation of politics rehabilitated, I want to take the high ground in this presentation.

Public policy matters – a lot, and so the environment in which policy is fashioned and championed matters much.

A degraded body politic, bereft of ideas and trust, can only presage degraded economic and social outcomes.

The voters generally get it (that is where a democratic right can be exercised).

The recent resounding victory by Britain's Boris shows that with the right set of ideas, messaged in a modern and catchy way, voters can be persuaded to do the right thing.

The two sets of radical reform episodes in New Zealand demonstrated in the mid-eighties and early nineties, that momentum for fundamental reform could be maintained through electoral cycles, and even better, sustained beyond the political life of the prime movers.

The ideas came first, then the institutions.

Start with ideas. The champion of New Zealand's much documented transformation was the idea of opening up; that allowing the free flow of money and markets would pay handsome dividends. As we turned our back on a closed economy dominated by state ownership, protectionism and high burdens of tax and regulation, the pay-off for the whole-hearted embrace of that idea came in the form of economic and job growth and a dramatic reining in of debt and deficits. Farming without subsidies, businesses facing markets not Ministers for their footing and their future, unilateral free trade and a de-regulated labour market all combined to foster a new dynamic.

Having tested a controlled economy to its near destructive death, opening up was the remedy.

But ideas need to be buttressed by institutions to ensure that they are not just bedded in, but sustained.

The pledge that monetary policy would never again be captive of politicians trying to inflate their way to victory, saw NZ pioneer the institution of an autonomous, but accountable central bank dedicated to the mission of price stability.

The pain of recurring blow outs in debt and deficits, saw the remedy of rules for fiscal prudence instituted with transparent and comprehensive accounting for public finances.

The waste and inefficiency in the public sector saw performance management regimes instituted for civil servants and corporate disciplines imposed on state owned enterprises hand in hand with regulatory reform and privatisations.

Some three decades on these ideas and institutions remain the centre of political gravity.

Let me move from then to now.

The forces of disruption that we see demonstrated every day in the business world, have unsurprisingly extended to the domains of politics.

The events governments grapple with have seen established orthodoxy turned on its head.

Central Banks doing 'whatever it takes', the constant cry to abandon fiscal prudence, some even calling it a fetish (the head of Germany's central bank no less), market systems derided daily and pedalled is the belief that wellbeing springs from state rather than private actors.

Layer over that the big geo-political disruption which is the inexorable rise of China with fundamental challenges to notions of democracy, international rules-based systems, private property rights and personal liberty.

The real risk for the West is that Governments lose their footing, trust is trashed, the economy flounders while citizens demand greater share of the collective pie.

A fellow thinker Downunder, Maurice Newman, put it well when he wrote in December of "a West tormented by indecision and social division. Belief in its values, institutions and systems is waning"

By my reckoning any successful anti-dote to all this democratic, economic and social turmoil will require political action to be anchored in first principles.

Central governments are by definition an exercise in intervention.

Sorting the intervention logic is what matters.

In office there is a constant tension between events and anchors – by which I mean a principled framework for governing.

So often events overwhelm the anchors; the intervention logic of principle is abandoned in favour of the expedient of the moment.

Rather than table a technical analysis (Boris's right hand man, Michael Gove famously declared "people in this country have had enough of experts") let me give you an erstwhile political practitioner's roadmap of governing for the times.

The **spirit** that drives the intervention counts most.

A spirit of freedom in all its forms both optimizes the outcomes, whether they be economic or social, political or personal as well as the democratic buy in.

Just take the pulse of a Hong Konger to know that the idea of liberty is not an abstract – it is visceral and personal.

And take the pulse of a new conservative voter in the north of England to know that the freedom to make decisions for one's own country rates above most all other matters.

The unambiguous link between markets without sand in their works and job growth validates both deregulation and the institution of rules of the game to counter monopolistic efforts to shut down markets.

Then there is the **shape** of the hard and soft infrastructure that underpins performance.

Noble gestures at vast public expense in the name of advancing hard infrastructure are the new fiscal 'fetish'.

Beware roads to nowhere. The business case, the cost benefit analysis, who funds and who pays for the ongoing maintenance all demand rigorous analysis. This must not be a political equation, but a sound growth and development enabler.

The soft infrastructure of human capacity is as critical as it is impervious to structural education reform. The very domain that should be the most dynamic is generally the most resistant to change. Politicians with purpose have managed to sponsor change at the margins, but the centrifugal force has proved to be organised producers not pupils who more than ever need skills passports to prosper.

Last on my roadmap list is the imperative to foster the **spark** of innovation.

While the shape of future discovery is unknown, what we do know is that it will be individuals and enterprises who will be the spark. We hear a lot about the licence to operate which so often is a stalking horse for regulation, control or outright prohibition. An atmosphere and a policy environment that gives the innovator the license to operate is of the essence.

Education excellence, ease of doing business, predictable tax regimes, frictionless trade all combine to produce the innovative DNA which is the stuff of future progress.

Francis Fukuyama of our MPS host, the Hoover Institution, famously wrote of the 'End of History', much misquoted.

Charting the 'Beginning of the Future' is for the bold, but I feel there are some golden rules of political action that will determine success or ultimate failure.

For sure Nations will make different choices, that's the attraction of policy freedom.

Nations governed with respect for the freedom of individuals and the law to back it, interventions that foster innovative DNA, governments that understand that wellbeing is best promoted by private dynamic not state actors and having the

benefit of high quality policy settings reflecting these imperatives for me spell success.

Nations whose citizens are required to trade economic progress for political dictate, where technology is the master not the servant, where centralised conceit usurps private decision making and are made to be prisoners of poor public policy will suffer.

In an age where there is serious flirting with socialism, the rise of a new would be hegemon who doesn't play by any of the freedom rules and distracted democracies it is worth noting that time and again it is markets that deliver the goods, individuals who innovate, and freedom that people strive for above all else.

RUTH RICHARDSON

FORMER MINISTER OF FINANCE, NEW ZEALAND

As New Zealand's Finance Minister from 1990 to 1993, the Honorable Ruth Richardson drove the nation's reform agenda and laid the foundation for its economic turnaround. Richardson was first elected to Parliament in 1981. In 1987, she was promoted to shadow minister of finance. Once in office as the Minister of Finance in 1990, she set about making radical reform, implementing market-style policies to secure New Zealand's economic recovery. These involved a major fiscal correction, deregulation of the labor market, recommitment to price stability, and early initiatives in redesigning social policy. On the back of those reforms, the economy grew by 20 percent, and New Zealand recorded the highest rate of job growth within the international Organisation for Economic Co-operation and Development.

Since leaving Parliament in 1994, Richardson has been in demand as a policy consultant to governments around the world on lifting standards of governance; on privatization; and on comprehensive macro, micro, labor market, public sector, and social policy reforms. Richardson mentors public and private figures extensively and has an extensive governance career, currently as the Chairman of the Kula Fund and New Zealand Merino Ltd., and as a director of Synlait Milk Ltd. and Bank of China (NZ) Ltd. She was previously director of the Reserve Bank of New Zealand. Richardson has received the Lincoln Medal from Lincoln University and honorary doctorates from the University of Canterbury and the Universidad Francisco Marroquin (Guatemala). In 1995 she published an insider account of the politics of reform in *Making a Difference* (Christchurch, NZ: Shoal Bay Press).

Public Policy, Private Actor

Dominique Lazanski

Mont Pelerin Society

From the Past to the Future: Ideas and Action for a Free Society

17 January 2020

OR….

How to be a Classical Liberal in the Private Sector and impact public debate and public policy

OR….

Don’t just sit there, do something!

Beliefs Matter
Ideas Matter

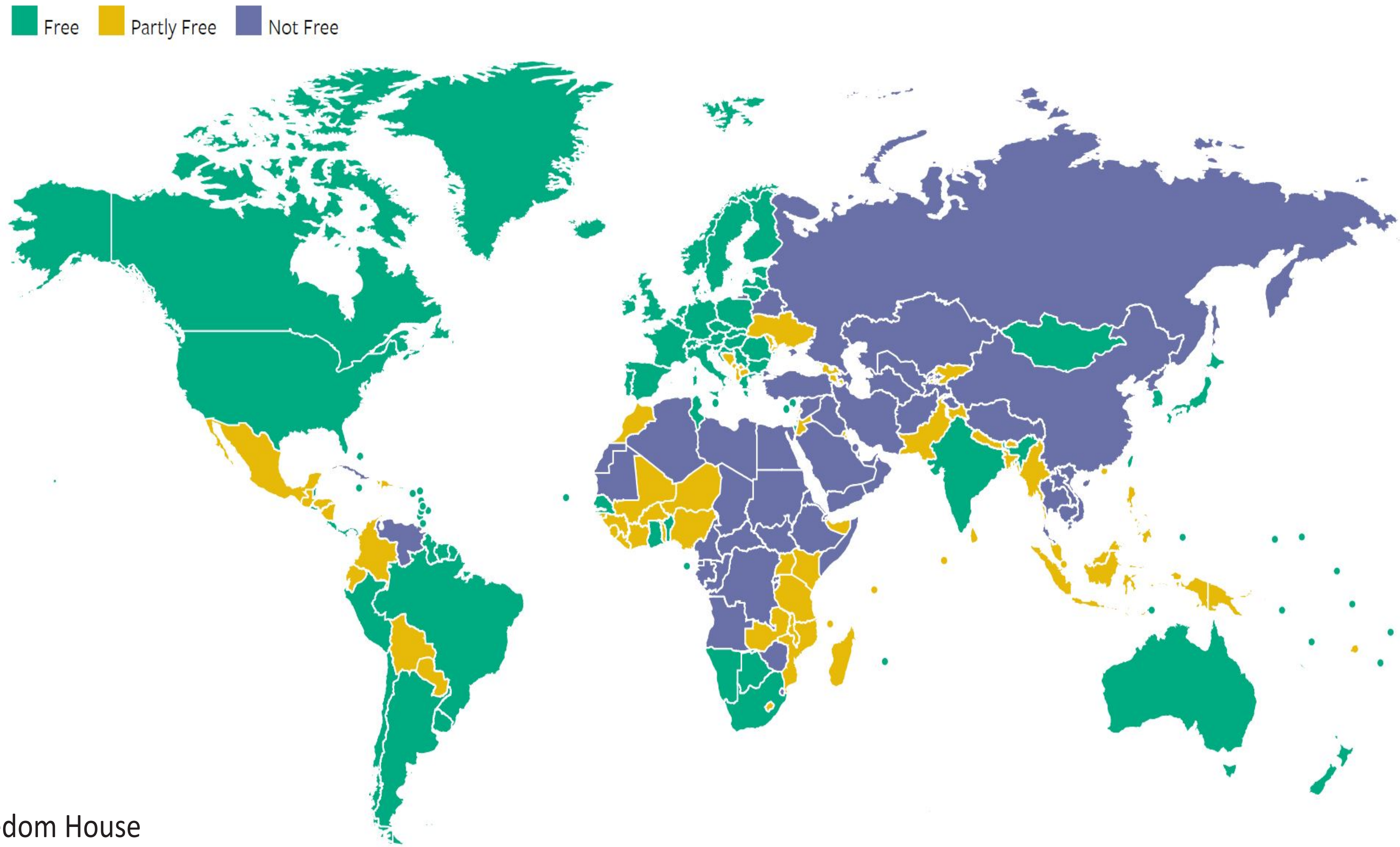
Two choices for changing the world:

1. Live well and work outside/circumvent government and institutions
2. Change institutions from within

Brian Crozier obituary

Intelligence expert who formed his own organisation to counter communist propaganda

▲ Brian Crozier (right) with Ronald Reagan in 1985. Photograph: Michael Crozier



Freedom House
2018-19

MENA Iran PS752 Ukraine

Video Apparently Showing Flight PS752 Missile Strike Geolocated to Iranian Suburb

January 9, 2020 By Bellingcat Investigation Team
Translations: Русский

On January 9th, a video spread online after it was posted onto a public Telegram channel showing what was apparently a mid-air explosion. The New York Times has contacted the person who filmed the video, received it in high resolution, and confirmed its authenticity. Below, an annotated version of the video created by Jake Godin (Newsy) highlights the events of the brief clip. (Uploaded directly here)

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U.N. Approves Resolution to Combat Cybercrime Despite Opposition From E.U., the U.S. and Others

By **CircleID Reporter**

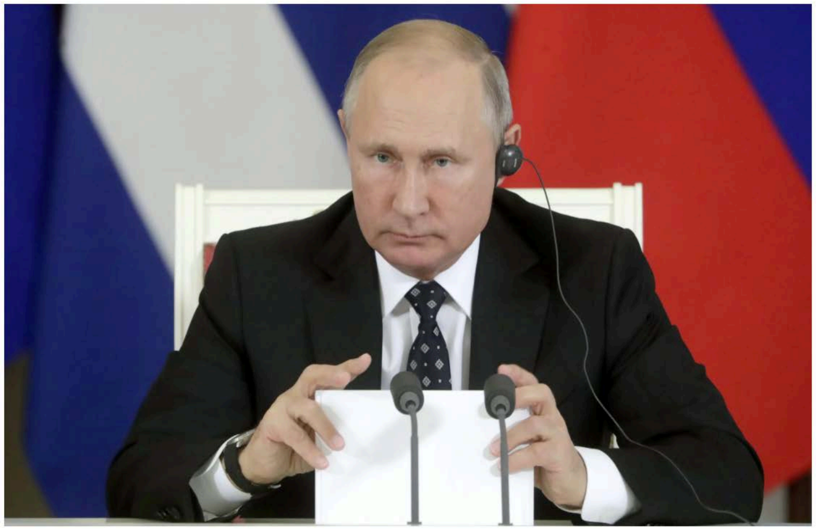
Dec 30, 2019 12:25 PM PST | Comments: 0 | Views: 4,768

The U.N. General Assembly has approved a resolution to start the proces
new international treaty against cybercrime despite objections from the Euro
the United States and other countries. The Russian-drafted resolution receiv
from a 193-member world body with a vote of 79-60 and 33 abstentions. The

Russia's test-run for its alternative internet a success, says Kremlin

share

Save 121



The tests on Monday were designed to ensure the "security" of its internet infrastructure in case of a foreign cyberattack. CREDIT: MIKHAIL METZEL /TASS

Articles

Governance in international technical standards-making: a tripartite model

Dominique Lazanski

Pages 362-379 | Received 15 Apr 2019, Accepted 24 Sep 2019, Published online: 11 Dec 2019

31 min PLAY

#23 China Wants to Dominate the Internet | Dominique Lazanski

China Unscripted

News

China and the US have two competing visions for the future of the global Internet. Don't like Internet censorship and mass surveillance? Better hope China doesn't get its way in the United Nations and Huawei doesn't build your 5G network. A VPN won't save you from China's internet police.

More Episodes

China shows its dominance in surveillance technology

Country's companies have made every submission to UN on standards in past three years

The UN has received 20 surveillance standards proposals since 2016 from Chinese groups, including Huawei © Fred Dufour/AFP

Anna Gross and **Madhumita Murgia** DECEMBER 27 2019 52

Thoughts on What to Do

- Be passionate about ideas
- Know your area well
- Be situationally aware and alert
- Media – war of words/change the debate
- Change or end institutions from within
- OR work around and outside the system

Thank you!

Dominique Lazanski

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Other Social Media: Lazanski

“The economic problem of society is thus not merely a problem of how to allocate "given" resources … ***it is a problem of the utilization of knowledge which is not given to anyone in its totality.”***

The Use of Knowledge in Society, **Hayek**, 1945

DOMINIQUE LAZANSKI

LAST PRESS LABEL

Dominique Lazanski is a London-based digital policy and strategy consultant and is the director of Last Press Label. She is currently a consultant for the UK Department for Digital, Culture, Media, and Sport and for mobile-related companies. She was formerly the director for public policy and institutional relations for the GSM Association and has worked on cybersecurity policy and internet governance coordination with organizations including the United Nations (UN), the Organisation for Economic Co-operation and Development, and the World Trade Organization. She was on the executive multistakeholder committee for NetMundial in April 2014 and just finished her three-year appointment to the multistakeholder advisory group of the Internet Governance Forum.

Lazanski was a member of the UK Open Data User Group in the Cabinet Office from 2012 to 2014 and the Tax Transparency Board in Her Majesty's Revenue and Customs in 2013. She participates on the Multistakeholder Advisory Group on Internet Governance in the United Kingdom. She worked on the first Cyberspace Conference with the UK Foreign Office and the ICC in London. In 2015 she was a UN expert on access and connectivity. Lazanski began her career with positions at Yahoo, eBay, and Apple, where she helped launch the first iTunes stores in the United States. In 2005 she moved to London to complete a master's degree in information systems management at the London School of Economics. Lazanski also holds a BA from Cornell University and a second master's degree from the University of Bath and is currently working on her PhD.

Cicero Institute

Libertarianism is Dysfunctional, but Liberty is Great

Joe Lonsdale

JANUARY 2019

American libertarianism has become a useless, purely performative sort of politics. Many libertarians I know seem blinded to the fact that the American social contract has fundamentally changed in character. At least since the New Deal, the political reality is that government involvement in our lives has increased in irreversible ways. But while libertarianism has become a form of unhelpful critique, liberty remains as vital as ever before. If we want to fix the most broken areas of our society, such as criminal justice, education, and healthcare, we must embrace policy solutions that mirror the competition of ideas that defines a free society. This means transparency and accountability. Wherever government is involved, we need systems that allow governing ideas to compete. Our rules need clear metrics, decision-makers need the freedom to experiment, and we must reward their successes and quickly eliminate failures.

The philosophy of liberty as generally understood by America's founding generation — including all it implies about speech, property, and other natural rights — should always be a vital part of the American identity. Libertarians of every age have understood that the wisest political orders must safeguard basic freedoms.

———

Liberty forces us to take personal responsibility for our decisions in the knowledge that each of us is the author of our own life. It is the foundation of our moral culture. Liberty is also the basic condition for aesthetic and cultural progress. “Experiments in living” produce the brilliant variety of human ingenuity and expression on display in the free world. Finally, liberty allows people to innovate and compete to deliver superior goods and services, which creates prosperity. If entrepreneurs are free to fail or to succeed in the marketplace of ideas, and entitled to the fruits of their labor, talented individuals will devise beautiful new ways to enrich the lives of others.

Too few people today understand why the word "LIBERTY" is inscribed on our coinage and our identity as a nation. Though some mock liberty as an outdated or abstract concept, it is as central to the health of our civilization as ever before.

But liberty is not enough. And I no longer call myself a libertarian.

———

The philosophy of liberty is ultimately a philosophy of restraint. It explains what government shouldn't or can't do. In libertarian theories such as Robert Nozick’s, most of the functions of modern government vanish in favor of a “night watchman state” so minimal that one would be hard pressed to find a single real example in human history.

In today's complex world, most Americans agree that the government *will* play a critical role in our economy, for example in education, healthcare entitlements, and the provision of a social safety net. Despite this basic reality, there are hundreds of thousands of smart libertarians on the sidelines griping at their TV screens about government dysfunction. Too many libertarians are shouting "no" instead of trying to help improve our society.

These “get off my lawn” libertarians convulsively reject any form of state activity. You see them in Congress, where Tea Party and Freedom Caucus Republicans grandstand and obstruct policy rather than fix our government. You probably even know one or two people who are so blinded by their *laissez-faire* ideology that they can’t recognize good policy when it’s staring them in the face. Let’s go over a quick example to teach them the value of positive policymaking.

Until about 50 years ago, many of our fellow citizens were still dying because dialysis machines were scarce and unaffordable. As a society, we decided that nobody should die of preventable kidney failure, and we decided to pay for it. In 1972 President Nixon and a bipartisan Congress amended the Social Security Act to say that government would cover dialysis as a remedy to end-stage renal disease for any American who needed it.

The knee-jerk reaction from the libertarian right is that government shouldn't be involved in healthcare at all. Your libertarian friend might interject: "In a wealthier society charity would pick up all these costs more efficiently." But let's be realistic: our country will never get rid of our system of state-sponsored healthcare. Even were such a thing possible, many might die in the transition period. The political reality in the US today is that we must continue paying for end-of-life kidney care for those who can't afford it. Anything else is disgraceful.

The better question is: why does dialysis cost taxpayers well over $35 billion annually, or a full 7% of the Medicare budget? The answer is that the federal government is willing to sponsor lifesaving care for people experiencing severe kidney failure, but *not* willing to sponsor preventive treatments that could effectively keep Americans from progressing into kidney failure. Our government accidentally created an incentive against preventive treatment, and even worse, against technological and medical innovations that could improve our ability to address early-stage kidney disease!

Fortunately, this is a problem *we can fix.* Even a libertarian should agree that if government is already paying for end-of-life care, it should certainly cover preventive measures that keep patients healthy instead of shackling patients to grim dialysis clinics. Imagine if Medicare paid for diagnostic screenings well in advance of kidney failure, and reimbursed providers for keeping early-stage patients from sliding into end-stage renal disease. We would immediately unleash innovations in preventive medicine that would save billions of dollars and keep hundreds of thousands of people from passing the point of no return![1]

Unfortunately, the hardened, dogmatic form of libertarianism that one often encounters in America today adds little to our political discourse. But an optimistic creed which draws on the lessons of liberty can improve American government in powerful ways and tackle major problems in our country.

In a society governed by the rule of law, individual freedom typically finds expression in a market setting where entrepreneurs peacefully compete to produce superior goods for others. A free market is a kind of "spontaneous order" which channels our acquisitive drives and instincts for glory towards service. As Albert Hirschman argued, free markets transform the sin of avarice into a civilizing virtue. Wouldn't it be great if we steered *auri sacra fames* towards solving challenging social problems typically addressed by government?

Any great policy does three things: it creates a clear but general incentive for government or private sector actors, it transparently tracks the performance of those actors, and then it holds them to account for their successes or failures. Rather than prescribing procedures or setting dozens of intermediate goals, policies should outline *ultimate metrics*, and give people creative

[1] As we have written elsewhere, preventive and in-home care models for patients with chronic kidney disease have been successful at lower costs. Medicare should embrace these models.

license to pursue these metrics in the ways they judge best. As Philip Howard puts it, “human responsibility is the oxygen of accomplishment.” Rewarding entrepreneurs and government employees for successfully achieving specific outcomes — such as preventing the escalation of kidney disease — maximizes freedom and creates the conditions for bottom-up competition in the provision of public goods. Dialysis is just one example. Consider two others:

Criminal justice. We incarcerate seven times as many people as we did in the 1970s, and about 70% of people reoffend within three years of their release from prison. We know that certain jails, prisons, and re-entry departments are better than others at rehabilitating offenders, but we reward them all with the same fixed fees for supervising their wards and carrying out a thousand minor procedures.

What if instead of paying our corrections officers to “warehouse” detainees we incentivized them to successfully help people reintegrate into society? In this new paradigm, corrections budgets would expand for facilities, departments, and counties that successfully reduce their return to incarceration rates. This kind of transparent rewards system would motivate state employees to iterate and figure out what can really reduce our corrections population while also reducing crime in our communities.

This model works because it harnesses the creativity and free judgment of corrections officers towards achieving a valuable social outcome. We’ve seen it work in my home state of California, which implemented exactly this model for felon probationers in 2009. As soon as the bipartisan law passed, California probation departments radically shifted their cultures and began behaving like entrepreneurs: experimenting with cognitive behavioral therapy, education, and other rehabilitative techniques to see how they could most effectively drive down recidivism rates.

In the past decade this institutional shift has steered roughly 100,000 probationers away from prison, saving state taxpayers over a billion dollars. Men and women who might have wound up in prison have been able to build lives outside of our corrections system. Imagine if the rest of American criminal justice was free to innovate and improve in the same way!

Higher education. Elizabeth Warren, Bernie Sanders, and others are loudly calling for the federal government to forgive some or all of the $1.5 trillion in student loans outstanding in this country. But the reason we’re in this mess is that our colleges and universities are not preparing American students for the kinds of successful careers that would allow them to pay off their student debt.

The federal government disburses nearly $100 billion in Title IV student loans per year, and nearly another $30 billion in grants to colleges and universities. This massive aid package flows to institutions of higher learning regardless of whether their students succeed or fail in the workforce. Colleges and universities are completely unaccountable, and alumni salary data has only recently become available. Is it any wonder that tens of millions of people are struggling to pay off their student loans?

To a free-thinking entrepreneur who appreciates market incentives, it’s obvious that we should make Title IV funding contingent on the performance of our colleges and universities. Policymakers typically describe “performance” in terms of graduation or degree completion rates. But imagine if colleges and universities were rewarded with more aid and more scholarship students on the basis of the *real earnings* of their graduates.

In this world, schools would compete furiously to figure out how to best advance the careers of their students. They would address quantified skills gaps by focusing on vocational training, partner with large corporations in need of new recruits, offer classes in the evenings when full-time workers and single moms can attend them, and try out new blends of online and physical instruction. Instead of allowing accreditation agencies to decide what schools can and can't teach, policymakers should reward schools for producing ultimate results based on metrics (like market salaries) that can't be gamed.

There are obviously nuances — this kind of proposal would have to adjust rewards for the fact that some students are more likely to attain high-paying jobs than others, as well as institutions like arts colleges for which this model doesn't make sense. But the basic philosophy is clear: give colleges and universities the liberty to experiment with different pedagogies and reward them for the result we care about most.

There are dozens of other non-partisan reforms to pursue in our country, at the federal, state, and local levels. Libertarians need to stop griping and start harnessing the best and brightest in the country to go *do them.* Our group, the Cicero Institute, is working with policymakers on both sides of the aisle to bring about reforms in healthcare, housing, and criminal justice that would help tens of millions of people and save tens of billions of dollars.

As Americans, we hold many values in common. The challenge is to promote sensible laws and institutions that bring about these shared values. We must ask: how can we expand opportunities for Americans to provide for ourselves and our families? How can we fight for reasonable costs of living instead of unaffordable medical bills, housing rents, and student loans? How can we prevent cronyism and corruption at the taxpayer's expense? And how can we address the legacies of inequality that halter working-class citizens and threaten the unity of our republic?

Libertarians should not abandon bold, controversial ideas such as replacing our welfare state with direct "universal basic income" to the poor, legalizing most drugs, liberalizing our immigration policy, or drastically simplifying the tax code. But they should first apply their perspective to solve problems on which we all agree. Let's channel our competitive drives and national genius into positive-sum projects in the service of others, whether in healthcare, criminal justice, education, or other areas of American life.

A more earthy, realistic American political philosophy will insist on the value of individual liberty while also recognizing that government will continue to be an instrument for solving social challenges. We must allow entrepreneurs and government employees to compete on the marketplace of ideas, transparently track their performance, and reward those who succeed. On a trellis of clear incentives, the vine of good governance may grow freely and flourish.

Our basic liberties have allowed a meritocracy of ideas to prevail in our country and made possible the past two centuries of economic growth and political progress. We can remain faithful to the insights that inspired our founding generation while also being honest about the realities of 21st century government. What we can learn from libertarians is something that libertarians themselves seem to have missed: that the philosophy of liberty is both idealistic *and* pragmatic.

When we give entrepreneurs the freedom to innovate and reward them for delivering the social outcomes we care about, they deliver beautiful and unpredictable solutions. We can harness the energy of our great entrepreneurial culture to improve the lives of the least well-off and allow the best ideas to scale. We're the best in the world at building innovative companies that transform lives across the globe. Let's bring the same energy to championing policies that serve the American public in powerful, measurable ways.

The duty of the modern libertarian is to stop grousing about American government and start fixing it. If we remain true to the principle of LIBERTY and sustain a healthy respect for the creative energies of free people, we can transform our government and improve the lives of Americans across the country.

JOE LONSDALE

8VC

Joe Lonsdale is a partner at 8VC, a San Francisco–based venture-capital fund. He was an early institutional investor in many notable companies, including Wish, Oculus, Oscar, Illumio, Blend, RelateIQ, Joby Aviation, Guardant Health, and Synthego, and in 2016 and 2017 he was the youngest member of the Forbes 100 Midas List. Lonsdale is a cofounder of Palantir, a multibillion-dollar global software company best known for its work in defense and finance.

More recently, Lonsdale was a founding partner at Formation 8, one of the top-performing private funds and the precursor to 8VC. Together, these funds manage a total committed capital of over $2.7 billion. He previously founded Addepar, which has over $1 trillion USD managed on its wealth-management technology platform, and OpenGov, which modernizes various processes for more than two thousand municipalities and state agencies. He is also a founder of Affinity, Anduin, and Esper. Lonsdale was an early executive at Clarium Capital, which he helped grow into a large global macro hedge fund. He also worked with PayPal while he was at Stanford.

Lonsdale and his wife, Tayler, are active in a variety of philanthropic and mission-driven pursuits involving public policy and liberty, classical arts, and health-care innovation. In addition to supporting various nonprofit organizations such as Thorn, an NGO which leverages technology to fight child trafficking, the Lonsdales are focused on harnessing the power of markets to create more opportunity for all parts of society. Lonsdale received a BS in computer science from Stanford in 2003. He often lectures and writes on entrepreneurship, technology, and public policy.

Presentation by: Sally C. Pipes, President, CEO, and Thomas W. Smith Fellow in Health Care Policy at PRI

MPS Hoover Meeting 1980-2020

"From the Past to the Future: Ideas and Actions for a Free Society"

Taking Ideas to Action in the Private Sector

"The False Promise of Medicare for All"

January 17, 2020

I would like to thank Professor John Taylor so much for inviting me to participate in this very special MPS meeting. It seems like just yesterday that I attended my first MPS meeting in 1980 at Hoover. So many of the great economists were there including long-time friends Milton and Rose Friedman. It was an amazing opportunity to see so many internationally renowned economists.

There are two prominent competing visions for health care reform for achieving universal coverage. One, and what I believe is the best solution for achieving affordable, accessible, quality care for all involves competition and choice—putting doctors and patients in charge of their health care.

The second vision and the one that is rapidly growing in support in the U.S. involves increasing the role of government in our health care system. The ultimate goal of this vision is a single payer system called "Medicare for All" or a stepping-stone approach to M4A through a public option.

I will focus my remarks on the false promise of single payer health care and will highlight the systems in two countries that have disastrous single payer (government) or virtual single payer systems—Canada and the U.K. I will conclude by providing a market-based plan based on competition and choice that would lead to universal coverage for all.

Understanding health care is similar to unravelling an onion, many layers and many tearful moments. With a few exceptions, many politicians do not feel comfortable talking about the issue as they find it too complicated.

I believe that health care will be at top of the list of domestic policy issues in the upcoming presidential election. The Democrats' top priority and their focus is on single payer (M4A) or on a stepping-stone approach such as a public option, Medicare Buy-In, Medicare for America, Medicaid Buy-in. It has been and will continue to be a major focus among the remaining Democratic candidates seeking the nomination for President.

WHAT'S AT STAKE IN AMERICA TODAY:

Republicans and Democrats alike need to develop and endorse a health care plan that puts doctors and patients in charge of their health care.

With the exception of a few so-called "moderate" Democrats like House Speaker Pelosi (D-SF) who want to build on Obamacare, the focus is on moving to single payer or a stepping-stone approach to M4A health care. Pelosi said in an interview in *Rolling Stone* on M4A: "$30 trillion. Now how do you pay for that?"

But during an appearance at a CNN town hall on Dec 5 Pelosi changed her mind where she expressed her dislike for the progressives' support of M4A and said the ACA could "be a path to M4A". She added "I'm not for doing away with Obamacare." I would rather call for "health care for all Americans. As we improve the ACA, it may lead to M4A. Put it all on the table, see what the benefits are to the consumer, to the patient, and when you do so, then compare it to what other options are. I think the ACA can be a path.

As former Senate Majority Leader Harry Reid (D-NV) said on Aug 20, he is not happy that some of his party's presidential candidates are pushing for M4A. When asked if M4A would be problematic in the 2020 election, he said "Of course it would be. How are you going to get it passed?"

At the 2019 annual meeting of the American Medical Association, the membership voted on a resolution not to support M4A by the closest vote ever 53 percent against and 47 percent for but to build on Obamacare. Bob Doherty, senior vice president for government affairs at the American College of Physicians, tweeted after the vote that such a strong showing within the AMA for single payer "would have been unimaginable in years past". The AMA only represents 20 percent of doctors.

THE FUTURE: PROGRESSIVES AGGRESSIVELY PROMOTE SINGLE PAYER OR "MEDICARE FOR ALL"

I am sure that most of you already know but I think it is important to define single payer—it means all private health insurance is banned and the government is the sole provider. This is what Senator Bernie Sanders, who I call the "Pied Piper of Single Payer", Senator Elizabeth Warren, and House member and chair of the Medicare for All Caucus, Pramila Jayapal (D-WA), are aggressively calling for in this country.

Progressives both in Congress and at the state level are aggressively sounding the siren call for single payer or "Medicare for All" health care. They would eliminate all co-pays, premiums, deductibles, and referrals to specialists. They would add free dental, vision, drugs, and long-term care for everyone. For those who think single payer cannot happen in the U.S., they are wrong.

Doug Holtz-Eakin, former CBO director under President George W. Bush and head of the American Action Forum, said recently "Progressive politicians and advocacy groups have made a single-health care system a major policy objective for the next two to four years. Those of us who believe that market forces and private innovation lead to the best outcomes should take this effort seriously. The appeal of single payer to an electorate worried about rising health care costs and weary of non-stop partisan battles should not be underestimated. Single payer can be framed as a panacea to all that ails us. Policymakers and especially proponents of the market, should "lean in" in this debate, examining what is 'single payer' and the implications of such a drastic shift in health care delivery for patients and providers."

In the U.S.: There are more Democrats who support single payer and it is more popular than ever before.

However, in the Kaiser Family Foundation's November 2019 poll, it shows that significantly more people support a Public Option than M4A. Among the overall public, 53 percent supported M4A while 65 percent support a "public option" that would compete against private insurance.

If all private health insurance companies and coverage were eliminated, support in the polls falls to 37 percent.

About 180 million Americans have Employer Sponsored Insurance. During WWII when wage and price controls were in effect, the federal government gave employers the ability to write off the cost of health care and employees get their coverage tax-free but, of course, their wages are lower. But, individuals cannot purchase their coverage with pre-tax dollars. This distorts the market and is a problem. However, 71 percent rate their ESI coverage as good or excellent. The November Gallup poll shows that 43 percent of Republicans are satisfied with U.S. healthcare costs, up from 26 percent. 9 percent of Democrats say the same, down from 13 percent last year. It is projected that the average individual employer plan in 2020 will cost an employer $15,000.

And, the polls show that if single payer would require most Americans to pay more in taxes, favorability fell also to 37 percent. The poll shows that overwhelming support for M4A falls significantly when people learn what it means!

Single payer emerged as a "hot" issue in the 2016 Democratic presidential race when Senator Sanders (I-VT) was running against Hillary Clinton. While he did not win, he aggressively introduced and ran on single payer. It is now the rallying cry for all of his political efforts and those of his proteges.

Senator Sanders is seeking the 2020 Democratic presidential nomination. He continues to campaign very hard on single payer, even after having emergency angioplasty heart surgery to repair a blocked artery in Vegas this fall where he received immediate and first-rate treatment. In the U.S., 2/3rds of patients who needed an urgent coronary angioplasty test got it within 24 hours. If Sanders had suffered his heart problem in *Canada, he should note that no one receives care within 24 hours and nearly 2/3rds* have to wait more than 3 days. Today in Canada, the average wait for angioplasty is 3 to 11 weeks. That's after an appointment with a specialist. In BC, patients face a median wait time of 2 weeks for "urgent" coronary bypass surgery and one week for "emergent" coronary artery bypass surgery.

Sanders has said "my liberal ideas were once seen as 'fringe' but are now infused in mainstream America. I am proud that we changed the political discourse in this country. That these ideas are widely accepted, are part of the mainstream, and are being supported by many Democratic candidates. If you recall, three years ago, these ideas were considered to be radical, extreme, and fringe ideas."

His fundamental belief is health care should be a right and not a privilege. "This is a struggle whose time has come."

Charles Blahous of the Mercatus Center released an analysis of the cost of Sanders' bill. He projected the increase in federal spending would be between $32.6 and $38.8 trillion over 10 years after accounting for any possible savings in administrative costs and lower priced drugs! The total cost would range between $54.6 and $60.7 trillion over 10 years. His estimates are similar to those of the Urban Institute and Rand. Today, the U.S. spends about $3.5 trillion a year or 18.2 percent of spending on health care.

Charles Blahous has added to his original cost estimate of an increase in federal spending of $32 to $38 trillion over 10 years saying that even if all personal and corporate taxes were doubled, the U.S. cannot bring down the cost of health care under M4A unless you cut payments to providers—doctors and hospitals. Sanders' plan would cut payments by 40 percent to match what doctors are paid for treating Medicare patients. This will lead to doctors quitting medicine. The American Assn of Medical Colleges has forecast there will be a shortage of 122,000 doctors by 2032 and that does not take into account moving to single payer.

Sanders'M4A plan is much more comprehensive than Canada's system as he also includes: free dental care, drugs (limit of $200 out of pocket), vision, no referrals for specialist appointments, no premiums, and no cost-sharing from patients such as co-pays and deductibles. Private insurance would be banned under his plan. To pay for it, there would be massive tax increases on American families, workers, and small businesses.

He would also cover long-term care delivered in home and community settings and coverage for 11 million illegal immigrants. He said "Hell, yes, my single payer health plan will cover 11 million illegal immigrants." He went on to say "Undocumented immigrants are human beings as well."

Sanders finally outlined several major tax increases to pay for his latest plan which he admitted would cost between $30 and $40 trillion over 10 years: a new 4 percent income tax on those earning more than $29 K a year, a new 7.5 percent payroll tax that will exempt the first $2 million in payroll, new marginal income tax rates on high earners, a 77 percent estate tax, and a new tax on large financial institutions. However, he has changed his mind and said he would not say how his plan would be paid for.

Sanders does not account for the fact that government will have to set a global budget on what it can spend on health care because there will be a tremendous increase in the demand for health care, supply will be limited, hence the result will be long waits and rationed care. Several left-wing economists agree with this statement. MIT economist Amy Finkelstein says "There is an enormous amount of evidence that leaves no doubt in any sensible person's mind that getting rid of cost-sharing provisions will increase demand for and the use of health care."

And, contrary to what Senator Sanders and other progressives say, single payer health care is not "free". In Canada, the Fraser Institute estimates in a new study that the average Canadian family this year will pay $13,311 in hidden taxes for care even if they don't pay directly for services that are rationed, have long waits, and have a shortage of doctors.

Even *NY Times* columnist Paul Krugman said "it is clear that Sanders is using Canadian health care as a political pawn to advance his own agenda. By supporting a single payer health care system, he is simply appealing to voters with unrealistic promises."

Single payer would make doctors under the control of the federal government. Under M4A, doctors would be paid Medicare rates which are 40 percent below what they are paid for treating patients with private coverage! Many doctors quit medicine or retire early under Obamacare's strict regulations and mandates. If a Democrat is elected president and single payer passes, not only will doctors retire early because of low pay and the inability to practice the type of medicine they trained for, I believe the best and brightest young people will not enter medicine leading to further shortages of doctors.

Candidates Joe Biden and Pete Buttigieg are not supporting M4A but a stepping-stone approach that builds on Obamacare and includes a public option in the exchanges at a cost of $750 billion over 10 years.

After being attacked over and over again in the debates for not providing a cost estimate of her M4A plan or how it would be paid for, Senator Warren finally released details of the costs and tax increases projected by Dr Don Berwick and Simon Jonson--$52 trillion in total over 10 years. The increase in federal spending over 10 years--$20.5 trillion.

Senator Warren would introduce legislation in the first 100 days of her presidency that would allow Americans to buy into a plan that would offer free coverage to all children and families making at or below 200 percent of the FPL or about $50,000 a year for a family of four. Americans who want government coverage could buy into a plan for a "modest" fee.

By Warren's third year in office, she will introduce and fight for a full transition to a M4A system that would enroll everyone living in the U.S. into a government-run system. "By this point, the American people will have experienced the full benefits of a true M4A option and they can see for themselves how that experience stacks up against high-priced care that requires them to fight tooth and nail against their insurance company."

The $52 trillion figure that she released for her M4A plan on Nov 1 is $7 trillion less than the number of $59 trillion from Mercatus, Rand Corp, and the Urban Institute! The reason for her lower number is that she has failed to figure in the additional cost of the many more people who will be covered under M4A because people think it is free!

Senator Warren keeps saying under her plan that there would be no tax increases on the middle class—not one penny. On SNL on Nov 2, host Colin Jost said “She promises not to raise middle class taxes by one penny but rather by several trillion pennies.”

How will she pay for her plan: Payroll tax on employers of $8.8 trillion over 10 years—employers will pass the cost on to employees in terms of lower wages and these employees are part of the middle class.

Wealth Tax: $3.76 trillion (Surtax on those earning over $50 million and billionaires will face an additional 6 percent tax on their wealth); Investment Taxes: $2 trillion; Foreign Earnings Tax: $1.65 trillion; Asset Depreciation: $1.25 trillion; Repealing Trump Tax Cut: $1 trillion; Repealing Corporate Profits Tax Cut: $1 trillion; Financial Transactions Tax: $800 billion; Big Banks Tax: $100 billion.

Warren admitted that 2 million would lose their jobs under her plan—1 million insurance administrators and 1 million doctors and hospitals. This is necessary to reduce the cost of health care. On the administrators she said they can get jobs in the auto and life insurance industries!

As Biden’s deputy campaign manager called out the math: “The mathematical gymnastics of this plan are all geared towards hiding a simple truth from voters: It’s impossible to pay for M4A without middle class tax increases.”

Washington Post deputy editorial page editor said Senator Warren’s plans to “remake the U.S. health care system with no private insurance coverage allowed ‘festooned with magic’ and ‘fanciful’.”

Mayor Pete Buttigieg has been rising in the polls. His “Medicare for All Who Want It” plan would offer a government-backed or “public” option for consumers alongside price controls geared towards protecting people who maintain their private plans. He has projected his plan at $1.5 trillion over a decade and claims to guarantee universal coverage while increasing subsidies for low income people who are insured through the exchanges.

Buttigieg says his administration would pay for the public option which includes automatic and retroactive enrollment for anyone without a private plan. This would be done by repealing the Trump tax cuts and seeking cost savings through administrative reforms. It is unclear how long Americans could maintain their private plans. “If private insurers are unable or unwilling to offer better plans than they do today, competition from THIS PUBLIC ALTERNATIVE WILL NATURALLY LEAD TO “MEDICARE FOR ALL”, he said. This is another stepping-stone approach.

HOW DOES SINGLE PAYER WORK IN PRACTICE: CANADA AND THE U.K.?

I have mentioned the hypothetical plans promoted by several Democratic presidential candidates and what they would mean for our health care. We need to look at the results from two countries that actually have such plans.

Canada: The Canadian government passed the Canada Health Act in 1984 bringing true single payer to the whole country. Doctors work for themselves but there is only one payer—the provincial government in the province they work in. Doctors are paid the same regardless of merit. They also face global budgets set by the province. Private coverage is outlawed for anything considered "medically necessary".

In a new OECD study looking at universal coverage systems, Canada is the only one of the nine countries (including the U.K., Australia, Netherlands, France, Germany, New Zealand, Sweden, and Switzerland) surveyed that outlaws private financing for medically necessary services.

Canada has one of the most expensive single payer health care systems in the developed world. But, there is an imbalance between the value Canadians receive and the relatively high amount of money they spend on their system--$13,311 in hidden taxes in 2018. It is among the top spenders on health care internationally.

With the government setting a cap on the share of GDP spent on health care, 11.2 percent compared to 18 percent in the U.S., the demand for care is much greater than the supply. The result: long waiting lists, rationed care, high taxes, and a doctor shortage.

In 2019, the average wait from seeing a primary care doctor to treatment by a specialist is 20.9 weeks, up from 9.3 weeks in 1993. This is the second longest wait time ever recorded. The average wait for an MRI is 11 weeks and for neurosurgery, 33 weeks. According to SecondStreet.org 323,000 Canadians leave Canada to get timely treatments abroad or in the U.S.

Wait times and rationed care are particularly problematic for the elderly. More than 2 million Canadians 55 and older reported "significant barriers when accessing the health care system." One-third of elderly patients waited more than 6 months for surgery while close to 25 percent waited that long to see a specialist.

The Fraser Institute released a 2019 study showing that 1 million Canadians lost $2.1 billion waiting for surgery or treatment in 2018.

Meanwhile there are scores of empty operating rooms sitting idle every night across Canada—a country with a penchant for training orthopedic surgeons, but not hiring them to treat patients on lengthy wait lists. This does not seem like a system to be overly boastful about." My niece could not get a job for three years after she graduated as an orthopaedic surgeon nor could any of her friends! No provincial government funds to pay them!

The latest international report from the Commonwealth Fund which compares 10 industrialized countries with universal health care including the U.S., found that Canadians experienced wait times more than any other country surveyed. 30% of Canadians reported waiting two months or longer for a specialist compared to 3% in Germany, 6% in the U.S., 7% in the Netherlands, and 9% in Switzerland.

Wait times pose real costs on patients and their families, including increased physical pain, mental anguish, loss of wages, and, in many cases, preventable illnesses turn into chronic, irreversible conditions, or event permanent disabilities. My mother died from colon cancer in Vancouver because she was too old to get a colonoscopy and there were too many younger people who went ahead of her—rationed care. Canadian crooner Michael Buble who lives in Vancouver found out that his three-year old son was diagnosed with liver cancer in 2016. They did not wait for care in Vancouver for treatment but immediately went to Children's Hospital in LA where he was treated by "fantastic doctors". Three years later Noah is cancer free.

Canada's health care system is riddled with poor access and performance. Canada ranks 25th out of 29 OECD countries with universal health coverage on the number of doctors practicing and last for acute care beds.

Canadians suffer from a lack of access to medical technology. It ranks 20th out of 27 countries in MRI units, 22nd out of 28 in CT scanners, and 18th out of 24 in PET scanners. But, Canada ranks third in terms of spending on health care, as a share of GDP among industrialized countries with universal health care. This combination of relatively high spending and comparatively poor performance should be a warning to us in America.

The Commonwealth Fund, based on survey results in 11 countries in 2016, reported nearly 33 percent of Canadian seniors said they were dissatisfied with the quality of care they received, compared to an average of 24 percent in many other countries. This has to do with the challenges of access that they face.

As Madam Chief Justice Beverley McLachlin who recently retired from the Canadian Supreme Court ruled in a 2005 case "Access to a waiting list is not access to health care." Having a care card does not mean you can get a doctor!

U.K.: Britain's universal coverage, two-tiered system is the National Health Service: on July 5, 2019 it celebrated its 71st anniversary. The system has been in financial distress since implementation. Massive sums are spent on the service, yet the NHS continues to fail patients with long waiting lists and rationed care.

The NHS is under strain with NHS Providers showing 100,000 vacancies—doctors, nurses, and health care workers in the U.K.

Nearly two-thirds of NHS trusts are breaking the 18-week wait limit for planned operations. NHS England states that 92 percent of patients must be treated in this time frame but only 75 trusts which run hospitals in the U.K met the target in Jan. 2019. 552,000 patients failed to be treated in the time frame. The target has not been met since 2016.

Brits have a higher risk of dying from cancer compared to other nations. It has been five years since the NHS cancer treatment target was last met. Nearly a quarter of all NHS cancer patients do not start treatment on time. The key cancer target was missed for more than 1,000 days. Hospitals should start treatment within 62 days of an urgent GP referral.

The results of a new survey by WHO that were reported in the medical journal *Lancet Oncology* showed that Britain is at the bottom of international league tables for 5-year cancer survival rates and is lagging 20 years behind some countries for some types of cancer. The U.K. is bottom of the table for bowel—58.9%, lung—14.7%, stomach—20.8%, pancreatic 7.9%, and rectal cancer—62.1%; second worst for oesophageal—16.2%; and third worst for ovarian cancer—37.1%. Two in three British cases of cancer, the disease was not being detected by GPs.

A 2019 report released in October by the British Government on the NHS offers a warning on the downsides of a single payer system. The report details increased wait times for services ranging from emergency room visits to cancer care. And, the study reports historic waiting lists totaling over 4.4 million people, up 40 percent in five years, for treatment with specialists.

The report shows cancer times are the worst on record.

The report finds that the NHS's performance is not meeting its standards in multiple statistical categories. In Sep 2019, 15 percent of ER patients experienced wait times of more than 4 hours before admission or discharge. The system's stated goal is 5 percent.

In August 2019, the new report said "78.5 percent of patients were treated within 62 days of urgent GP referral of cancer wait times. During 2018 and 2019, record low performance against this target was recorded. The target of 85 percent has been missed for all but one month since April 2014.

The Royal College of Physicians and Surgeons said on March 16 that the NHS needs to take "urgent action" to clear the backlog of patients needing surgery as nearly 230,000 people have been waiting at least six months for treatment. It found more than 36,000 patients have been waiting more than 9 months and that is despite a mild winter this year.

Waiting times at A&E units are at their worst level since records began according to official figures. Only 84.2 percent of patients being seen within the four-hour target. There is talk of the four-hour A&E being eliminated as it cannot be met. A&E waiting times in England hit the worst level in 15 years meaning that in July 2019, 275,000 ER patients waited more than 4 hours to be seen. They waited longer than they should as hospitals faced huge pressure to find beds.

Chief hospital inspector Professor Ted Baker warned of the normalization of "wholly unsatisfactory" treatment that endangers patients and the inability to guard against unacceptable and unsafe practices of "piling patients into corridors" that lack staffing for sufficient oversight. Baker described the NHS "as a relic in urgent need of transformation that was overwhelmed and only going to worsen."

No wonder 75-year old Rolling Stone Mick Jagger had his heart valve replacement surgery at NY Presbyterian and not in the U.K. under either the NHS. As his brother Chris age 71 said "At least Mick has not got to wait in line for the NHS."

CONCLUSION:

There is no question that single payer or "Medicare for All" is no longer a "pie in the sky idea" in the U.S. It is a serious issue among Democrats at the state and national level. These politicians are telling the American people that "Health Care is a Right." It is not a right. We have the right to access the type of health care that suits our individual needs.

Single payer cannot become the law of the land today. The Democrats would have to win the presidency, keep the House and take back the Senate in the 2020 presidential election. Because of the massive support for M4A, the time is now to educate Americans on why such a system is the wrong prescription for our health care system.

We want a system that offers competition, one that empowers doctors and patients, not putting total control in the hands of the federal government. Just like I have explained with examples from the single payer systems in Canada and the U.K., we will have: new higher and new taxes, long waiting times, rationed care, and doctor shortages. The time to fight, educate, and expose the myths to Americans is now!

The cure for our healthcare system lies in giving Americans choices in the type of health care plan they want. Some reforms include:

*Change the tax code to allow individuals to purchase their health care with pre-tax dollars just as those with ESI do.

*Expand HSAs: increase the amount of money that can be put into an HSA. They now cover over 21 million Americans. Allow contributions to be used for premiums. Allow those on Medicare to contribute to an HSA.

* Reform Medicare by raising the age of eligibility and means test it.

*Reform Medicaid through block grants to the states so that those eligible can purchase HMO-type plans. On March 14, CMS rolled out new tools to help states pursue 1115 demonstration waivers so they can get approval to make changes to Medicaid including implementing work requirements.

Today, under Medicaid, 74 million Americans are covered including 15 million added under the Obamacare Medicaid expansion plan.

*For patients with pre-existing conditions who are not in the ESI market, the feds should provide adequate funding to the states so that they can beef up or build high risk pools that would provide affordable, accessible, quality care to this segment of the population.

Individuals should be able to purchase their coverage and as long as they keep renewing their coverage every year, they should be able to keep their premiums at reasonable rates when they are young and healthy.

*Medical malpractice reform is needed. The cost of med-mal according to PricewaterhouseCoopers is over $210 billion/yr.

*CMS has started in March a public comment period seeking feedback from the states regarding possible federal reform that would make it easier for health insurers to sell plans across state lines.

As CMS Administrator Seema Verma so cogently said at a speech in San Francisco "Medicare for All" will become "Medicare for None".

Fortunately, President Trump has said he does not support single payer! We cannot afford it!

If America adopts single payer in the next few years, this country will be on the "Road to Serfdom". There will be no off-ramp and we will have "single payer" forever.

The late political commentator Charles Krauthammer predicted in May 2017, "we will have single payer in America in seven years!"

I hope you will read my new book *False Premise, False Promise: The Disastrous Reality of Medicare for All* (Encounter Books, January 2020).

To achieve universal coverage in this country, we need choice and competition. That is the way to reach affordable, accessible, quality care for all.

As my friend PJ O'Rourke so aptly said "If you think health care is expensive now, just wait until it's free!"

SALLY PIPES

PACIFIC RESEARCH INSTITUTE

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China, Globalization, Capitalism, Silicon Valley, Political Correctness, and Exceptionalism
A Conversation Between Peter Thiel and Peter Robinson

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Peter Robinson: The late economist and foreign policy analyst Hoover fellow Henry Rowen writing in 1996, quote, "When will China become a democracy? "The answer is around the year 2015. "This prediction is based on China's steady "and impressive economic growth, "which in turn fits the pattern of the way in which freedom "has grown in Asia and elsewhere in the World." Worked in South Korea, worked in Taiwan. Economic growth leads to democracy. In China, what went wrong?

Peter Thiel: Well, Peter, this is always a set up for me to start by both flattering you and criticizing you a little bit, since there was that very famous Reagan speech you gave, that you wrote for Reagan, where it was, you know, tear down that wall, Mr. Gorbachev, and it was very effective. But it was perhaps, it was not only in the West that we learned lessons from it, the Chinese communists also paid very careful attention to it, and they learned that you had to have perestroika without glasnost. You had to get rid of the Marxism without getting rid of the Leninism, and they learned somehow the very opposite lessons of that fateful year 1989. You know, Tiananmen worked in China and that is what is continued to work. So I think that's sort of a simple first cut. There is nothing about history that is automatic or predetermined. It's always a question of agency, of people, and unfortunately, China took the lesson very much to heart and has stayed on this trajectory. You know, its per capita GDP is close to $10,000, which was sort of the point where democracy was supposed to start taking over, and it seems to have, if anything, been going the opposite direction. Or there's another sort of historical riff I have on this that I was thinking about the other day, where there was this famous interview with Zhou Enlai in the early 1970s where they asked him about the French Revolution and what did he think of the French Revolution, and he said, you know, it's too early to tell, which was seen as sort of a funny diplomatic answer at the time. But I've come to think that there's sort of a very sinister way of thinking about that answer which is that in some sense, the French Revolution, it ended. It ended in 1794 when the insanity burned itself out and you had Thermidor. And then of course when you had the Russian Revolution, one of the promises Lenin had was that the Russian Revolution, the communist revolution, would never have a Thermidor. But it took a little bit longer than five years as it did in France, but I'd argue you had something like Thermidor, 1956 when Khrushchev gave the anti-Stalin speech, certainly by the time of Gorbachev. China, what Zhou Enlai was saying in that speech was that China is the one country that is still true to the spirit of the French Revolution. It is the one country in the world in which there will never be a Thermidor. And then of course the way this manifests is that it will still, you know, continue in the sort of revolutionary communism that will have one genocidal thing after another, and that continues under Xi.

Peter Robinson: Still China, three quotations, two of them from heroes of the Mont Pelerin Society. Friedrich Hayek in 1982, "The mere idea that a planning authority could ever "possess the information necessary to run the economy "is a somewhat comic fiction. "What prices ought to be can never be determined "without competitive markets," close quote. If you want economic growth, you must permit free markets. Quotation two, Milton Friedman, 1991, "When the regime in China introduced "a greater measure of economic freedom "that generated pressure for more political freedom "and that led to Tiananmen Square." If you permit free markets sooner or later your people will demand political freedom and they'll be hard to handle. Quotation number three, Peter Thiel, speaking last November, "Artificial intelligence is the big eye of Sauron, "watching you at all times, in all places." Close quote. Will artificial intelligence overturn Hayek and Friedman? Will it enable China to achieve sustained economic growth without economic or political freedom?

Peter Thiel: Well, let's not be too dogmatic in answering this. So, you know, I certainly think that it's possible that the totalitarian, the form that totalitarianism has in China will exhaust itself, that it will hit some kind of crisis at some point. China does have some very serious demographic challenges. Maybe it's sort of like, you could say it's a revealed preference that people don't want to have children because it would be very cruel to allow a child to be born into such a horrible society. So I think there are ways that we can speculate on how it might ultimately exhaust itself. But I think we should not be dogmatic on the other side and assume that it automatically will, and that perhaps it can sort of develop, perhaps it can sort of catch up, you could sort of get things to work. And there are probably certain parts of the economy where you don't need to be that free or that creative or that innovative, there is just sort of a copying things that work. Just, you know, copying the West. And maybe you can't get quite to our standard of living but maybe you can get to a half of our standard of living or something like that.

Peter Robinson: But you're not singling out AI as a game changer here. You tend to pooh-pooh the notion that AI will change things.

Peter Thiel: Well, I think it's unclear, I think there's always a lot of propaganda around all these buzzwords and so I think it's somewhat exaggerated, but yes of course, there's sort a continuation of the computer revolution where you'll have, you know, more powerful Leninist controls and you can have certain, you know, maybe the farmers can sell the cabbages in the market and you can still have face recognition software that tracks people at all times and all places, and so there's sort of a hybrid thing that might work for longer than we'd like.

Peter Robinson: Okay, so you touched on this a moment ago but let's bear in on it. Two competing narratives, one is that President Xi is centralizing power more tightly, and with the help of technology, more successfully, than any other central authority has ever been able to do in all of human history. He is the most successful dictator the world has seen. The other narrative is that the Chinese population is growing old, its economy is slowing, its one-child policy has produced 40 million more men than women, and that the freedom movements in Hong Kong and Taiwan have placed Beijing seriously on the defensive. So--

Peter Thiel: Well, let's--

Peter Robinson: You're gonna choose one or the other or?

Peter Thiel: Well, let me--

Peter Robinson: How close are we to a Brezhnev moment?

Peter Thiel: I'm gonna give you my speculative conspiracy theory on how the Chinese communists are trying to psychologically undermine the West, and I believe they are inducing two perspectives on China in the West. One perspective is that China is very far behind us, that it's still a very poor backward country. Even in 2049, even on the 100-year anniversary, it will still only be a middle-income country, and it's so far behind that we don't need to worry about it and we can be in denial about China. And the other one is that it's so far ahead of us that there is no way that we can ever catch up. It is, you know, it works better, there's certain things where it can, you know, build skyscrapers super fast, there's certain things where it works so much better that we have to just accept that we are really far behind. And, you know, denial is extreme optimism, acceptance is extreme pessimism, but extreme optimism and extreme pessimism converge to doing nothing. There was, for example, I think there was this question about Taiwan and how protected Taiwan was and I believe it was in a single month in the year 2005 where the US strategic assessment shifted from Taiwan would be safe for decades because of our aircraft carriers and whatnot, to, no, Taiwan was already lost because China had all these missiles that they could knock all our defenses out overnight. And so it's somehow, so the fact that it gets framed in these two extreme terms, I'm wondering if you're sort of a mouthpiece of the Chinese communist party and it's always extreme acceptance and extreme denial, and the reality is actually, no, it's close, and there are strengths the US has and there's strengths they have and it's a fight, and it's gonna be a fight for a very long time. And even if China in some ways gains ground in that fight it will be strategically close for a long time because as China gains ground, other countries will get more scared of China and they will work more closely with the US. Japan was toying with the idea of shifting its alliance from the US to China, this was always the DPJ line in Japan in the late '90s, early 2000s. Under Abe, that's definitively over. Japan is back firmly on the side of the US. Vietnam, you know, much more on the US side than the China side. This is very different from Vietnam of 40 years ago. And so even if China sort of gains ground in certain things, I think the strategic picture will stay very even for a really long time. So somehow it's in between is probably the truth and it will be the truth for a long time.

Peter Robinson: So the notion is the Chinese want us to believe two statements, one is there's nothing to worry about, the other is resistance is futile. And both are frauds.

Peter Thiel: It's China is super weak, and China is super strong. And I've been in meetings in China where in some sense you got both messages within 20 minutes of one another, and it's like logically inconsistent but psychologically it doubles up.

Peter Robinson: All right. The United States is the center of the resistance. Let's take a moment or two considering what we need to resist right here. Zombie socialism, socialism rising from the dead. Again, a couple of quotations, the first from "A History of the Mont Pelerin Society." "In the 1980s and '90s members of the Society "had the exhilarating feeling "that things were at last going their way. "Several countries, "starting with Margaret Thatcher's government in Britain, "were privatizing their state industries. "Governments from China to India to America to France "were liberalizing, retrenching, or cutting taxes. "And then in 1989, with astonishing speed, "the Iron Curtain fell." Here's quotation number two. This is Bernie Sanders, he's speaking in 1989, the year the Berlin Wall came down, quote, "In Vermont, everybody knows I'm a socialist "and that many people in our movement are socialists. "And I think there's been too much of a reluctance "on the part of progressives and radicals "to use the word socialism," close quote. As we sit here this evening, the self-avowed socialist Bernie Sanders is tipped by many to win the Democratic caucuses in Iowa on February 3rd. From the triumph of democratic capitalism and all that the Mont Pelerin Society stands for to the re-emergence of socialism. How did this happen?

Peter Thiel: Well, these are like sweeping questions, there are all these different answers one could give but--

Peter Robinson: Choose three.

Peter Thiel: Let's just challenge a little bit the premise of that question. I don't think he's really a socialist in the sense, I mean there's no five-year plan, he doesn't actually claim that's he's gonna make the post office or the DMV work better. If he was promising things like this it would just be completely ridiculous. And, you know, the way in which socialism works is it's just this thing that's really different, and it's different, and it's meant in opposition to the zombie institutions in our society. And there is a problem that we have, you know, we don't have a very well-functioning capitalist society. There's a generational problem where it is difficult for young people to acquire capital, and that's the young people that are supporting Bernie Sanders. And the sort of the two simple political things that one should really think about are the runaway student debt in colleges, you know, it was $300 billion in student debt in 2000, it's up to $1.7 trillion today, and if you start your life in debt that can never be discharged in bankruptcy it will be much harder to accumulate capital and you might be less friendly to capitalism. So that is a big problem. And I don't think we should socialize the student debt but we should deal with it in a non-socialist way, we should internalize the costs onto the universities. We should redo the bankruptcy laws, yes, you can discharge the student debt, and when you discharge it, it's the college that gave you a bad education that gets stuck with the bill. This is the non-socialist alternative. And then I think the other basic problem of a lack of capital or inequality is that it's very hard for people to get onto the housing ladder. The main way that the people in the middle class in this country accumulate capital is through owning real estate, through owning your house, and if through a series of urban zoning laws and bad planning and impossibility of building things, it has become impossible for people to get onto that, and if you could find ways for people to own more houses you would have much less of the sort of millennial crazed socialism. So I think, you know, we should try to understand where it's coming from, we need to try to solve it, but at the end of the day I think it will be pretty weak because it's mainly a critique. It's a critique of bad institutions, and if Sanders becomes serious I think it'll be as scary as Corbyn was in the UK, and obviously we'll be talking about the post office and the DMV and it'll just be ridiculous.

Peter Robinson: Bernie Sanders can not get elected, any more than--

Peter Thiel: He can't get elected.

Peter Robinson: He cannot, all right. The universities, you touched on this a moment ago. Again, a couple of quotations, Michelle Obama, "The one thing I've been telling my daughters "is that I don't want them to choose a name university. "There are thousands of amazing universities "in this country." Quotation number two, Peter Thiel, "Of course we knew she was lying."

Peter Thiel: Yeah, this was an interview they gave just before their eldest daughter Malia was thinking about what university to go to. It was sort of in the context of always this sort of question of fact checking and politicians lying, and I think that the facts we need to check the most and the lies we need to call people out on the most are the really big lies that everybody tells. And so I added that it was actually, I mean, it would've been disturbing if they weren't lying. I mean, if they actually believed that nonsense that would've been really disturbing.

Peter Robinson: And where did Malia end up going?

Peter Thiel: She went to Harvard.

Peter Thiel: But look, it's always, is a theme that, I can go on all these critiques of the universities, but basically, the basic problem is if you think of it as an economic good, you know, is it a consumption good, is it an investment good, so is it an investment where you're investing for your future? Is it a four year party? Okay, that hybrid is pretty weird, but I think it's actually a hybrid of an insurance policy that people buy to avoid falling through the big cracks in our society and a tournament, a zero-sum tournament, where the elite universities like Harvard and Stanford are basically sort of a Studio 54 nightclub with a long line and a big velvet rope. And if you were the president of Stanford or of Harvard and if you had some kind of crazed martyr complex where you wanted a mob of students, faculty and alumni to come after you, you should give a speech saying this university is offering a great education and Harvard, you know, it used to just educate the 200 million people who live in the US, today it's educating the eight billion people in the world, and so we should increase the enrollment, not by a factor of 40 but let's say two or three over the next 20 years, and you would just get lynched because you're running a Studio 54 nightclub and you shouldn't forget it.

Peter Robinson: Political correctness at the universities. This is you, I'm quoting you once again, "If you have a majority of the vote, that's good. "If you get 70%, that's even better. "And if you get 99.99% of the vote, you're in North Korea." In 2016, how many professors at the top five law schools endorsed Donald Trump?

Peter Thiel: Zero. And the law school example's interesting because you would think it's one where if you took the, a lot of academic fields are more internal to academia, but law is one that sort of cashes out in a governmental political context, and taking a contrarian position in theory is quite valuable. You know, if you're a tenured law professor at Harvard, and you're the only law professor at a top law school to endorse Trump, I don't know, I think there would be like a 50% chance you would've gotten nominated to the Supreme Court or something like that. So it seems like it's the sort of thing where the contrarian thing would be quite valuable, and then if nobody takes that bet, I mean, wow, there must be some unbelievable enforcement mechanisms, and it's sort of like a gentle version of North Korea. But it's like, you know, even though you have tenure, it's like, wow, they can relegate you to some broom closet and play loud music or something. They'll figure out some way to punish you.

Peter Robinson: Silicon Valley. We've discussed this a number of times. When you were starting PayPal, you have said many times, the whole Valley felt as if it was truly dedicated to free markets and entrepreneurship and if you talked about politics you were wasting your time. Today it feels woke, more than woke, and I'm going to quote you again, "In recent years, Silicon Valley has become "completely deranged," close quote. What is the nature of that derangement and how did that happen?

Peter Thiel: Well, this one's actually hard for me to explain because it's quite a, it's a remarkable shift, certainly, from 20 years ago. I would say that there is a question how much innovation is actually happening that I always come back to, where I'm somewhat on the sort of side that we've had generally limited progress in technology and science the last 50 years. There was a very big exception in computer software, Internet, mobile Internet, the last quarter century. This was sort of this narrow cone of progress in the world of bits that really drove things. And I sort of wonder if there's actually less innovation possible even in those areas at this point. And so if you look back over the last five years, let's say, there have been fewer new consumer Internet companies that have come out, and sort of, maybe the easy ideas have been picked, maybe we need to move on to other areas but the other areas are regulated and difficult, so biotech or, you know, all kinds of futuristic science areas are deceptively hard, and we're in a zone where the returns accrue to the larger companies. So if you say, if you're sort of in an early innovative boom phase, like the dot-com boom in the '90s, it's all startups, it's in small companies that you start new things. You know, when I started PayPal in 1998, one of the questions I was always asked was why can't a big bank just do this? And I never really had a good answer to it. I now think the answer is roughly that most big corporate institutions are very political, they're very slow, they're not actually good at innovating, and that's why you have startups, that's why you have small companies, that's why you're able to merge and the big banks are too political to do anything new. And so if you can do something new and you can do it reasonably quickly there's space to do this. And I think the ratio of these bigger to smaller ones has shifted a lot and it is probably just a less innovative place. And then this cashes out in all sorts of ways politically. There's of course, you know, these things are always overdetermined. You can say it's linked to California. California was a 50/50 Republican Democrat state 40 years ago, now it's a D plus 30, it's the second most Democratic state in this country and so there's sort of a way in which the environment pushes it. There's probably a degree to which the workforce in Silicon Valley is the most educated in the country, has the most advanced degrees, college degrees and advanced degrees, and from the elite universities, and maybe the more education you have the more brainwashed you are, and so there's sort of a version of that. But I think there are parts of it that seem completely unhinged. You know, Elizabeth Warren is taking out these banners saying that she would, in Silicon Valley these billboards saying that she would break up Facebook, Google, Amazon for antitrust. Maybe it's shifted a little bit but the first two, three quarters of 2019 among Google employees, and I think Google's the craziest of the big tech companies, Elizabeth Warren got a plurality of the donations. She got more donations than anybody else. And so if she were, by some miracle, to get elected I think she would be able to argue that even the people at the big tech companies think they should be destroyed. And so there are parts of it that seem just completely deranged in ways I can't fully explain.

Peter Robinson: Visions of the future. During a trip to Europe last year, you realized that, at least in Western Europe, there are really only three visions of the future on offer. Vision one, accommodation more or less, in one way or another, with Sharia. Explain.

Peter Thiel: Well, I would say that, I think in politics or culture for the future to have power over the present, let me start with the general point, it has to be different from the present. The future has power because it's a time that will look different from the present and so it can't just be an endless Groundhog Day. If it's just always the same, it's just always repetition, then the future does not have any appeal and that's not part of a political agenda. And so if we look at Europe and we say, well, how will Europe be different from the way it is today in the future? I think there's sort of three pictures of a very different future, and sort of behind door number one is Islamic Sharia law, and if you're a woman, you'll be wearing a burka. So that's a very different picture of the future, it's very concrete. Behind door number two is the Chinese communist AI, and it's the big eye of Sauron that will be watching you at all times and all places. That's door number two for the future. And door number three is the green movement, and you'll be puttering around in an E scooter and you'll be separating out your garbage in a recycling can. And then I think the challenge is that there are no other doors. Those are the three options. And this is a, even though I'm not a crazy environmentalist, this would be my sort of argument for why the green stuff has so much traction in Europe. If those are the only three options, you know, I'll go with Greta.

Peter Robinson: But there are two places maybe, I'm putting this to you to see what you think of it, where there is a fourth vision of the future that involves economic growth, a reassertion of economic growth, a reassertion of national sovereignty, and a reassertion of cultural self-confidence, and those two places would be the United Kingdom of Boris Johnson and the United States of Donald Trump. You gonna go for that?

Peter Thiel: I would go with much more, you know, well, UK is sort of, US much more than the UK but--

Peter Robinson: I'll drop the UK completely. I'm trying to work a deal out--

Peter Thiel: They're trying.

Peter Robinson: To see what you go for.

Peter Thiel: I would go with Israel over the UK if you forced me to list two. But sure, let's say US, UK, Israel, I'll go with those three.

Peter Robinson: Okay, okay, that's, that's, usually I try to ask questions to which I already know the answer.

Peter Thiel: UK's sort of half way between the US and Europe, so it's better than Europe and it's worse than the US.

Peter Robinson: All right, Peter, quoting you again last November, "I would encourage us," and you were talking to a conservative crowd, like this crowd, "I would encourage us to rethink "the doctrine of American exceptionalism." What did you mean by that?

Peter Thiel: Well, it's again, it's this question of how we're stacking up as a country, and I think the analogy that I have made to exceptionalism is that it's like the radically monotheistic God of Islam and Judaism, where it's so one of a kind and so radically different that it can't be compared or measured in any way. And so when we say that we are exceptional we are often saying that we're so different that we can't even make sense of how we're doing, and then one gets the suspicion that there's a way that exceptionalism can degenerate into a cover for all sorts of things that are exceptionally out of kilter. And so you have a society in which people are exceptionally addicted to opioids, or we have a society in which people are exceptionally overweight, or we have a society in which people are exceptionally un-self-aware. And the alternative that I would pose is something more like greatness, where it's a comparative function and we would ask questions, you know, how are we stacking up? How are we stacking up compared to our past? How are we stacking up compared to other countries? And that's where, they're all sorts of questions that would come to the fore. I think, coming back to the stagnation one, one of the things that I would want to quantify more is in the world of science, we can quantify things to an incredible degree of Avogadro's number, the fine-structure constant in physics, all these things are precise to many significant figures. But the question about the rate of progress of science, of innovation, is incredibly unquantified, and it's just sort of hand-waving, and if you have sort of this Panglossian hand-waving where everything's exceptional and we're accelerating at the fastest pace possible, and it's not measurable, my sort of suspicion is that these are sort of the ever-narrower communities of sub-experts, the string theorists, the cancer researchers, telling us how great the string theorists and the cancer researchers respectively are. It's a place where there's no outside check, no reality check, no ability to really keep score, and you are certainly not exceptional and you're not even great.

Peter Robinson: Once again from "The History of the Mont Pelerin Society," quote, "The original members shared "a common sense of crisis, "a conviction that freedom was being threatened "and that something should be done about it. "They concluded that the threat arose "from erroneous theories so they committed themselves "not to political action "but to winning the intellectual battle of ideas." Close quote. Here are some members of the Mont Pelerin Society over the years, Milton Friedman, Friedrich Hayek, George Stigler, Gary Becker, James Buchanan, and others have won Nobel Prizes. Has the intellectual battle been won such that we should all shift our attention to political action?

Peter Thiel: I don't think the intellectual battle is ever fully over because I don't think history's over, and I would say if anything, if I had to sort of characterize the intellectual landscape, we've been in a world for a very long time in which somehow the range of intellectual debate has gotten more and more narrow, and sort of the Overton window's shifted to the left but generally in an ever narrower way. And you could sort of say that we've been in a bear market for ideas I think for something like the last 50 years. And so a lot of the people you cited I think of as pre the late 1960s and that in last 50 years if you had crazy ideas, if you had ideas that were outside the box, those were always bad and you got clobbered and you couldn't get tenure, you couldn't get funding because everything was peer reviewed up the wazoo. And I think we're now at a point where we've been in such a long bear market for ideas and the Overton window is so uncomfortably narrow that I would be long ideas more than at any other point in the last 50 years. I think we're not gonna find solutions inside the intellectual straitjacket in which our universities and our society put us and I think there will be positive returns to ideas greater than there have been in the last 50 years.

Peter Robinson: Last couple of questions, this one begins, again, by quoting Milton Friedman, "I believe a relatively free economy "is a necessary condition for a democratic society. "But I also believe there is evidence "that a democratic society, once established, "destroys a free economy," close quote. Do we really have any reason at all for optimism or is the whole magnificent project doomed?

Peter Thiel: I think always extreme optimism, extreme pessimism, are both equally wrong. As a libertarian, we should always, libertarians, we should always come back to the question of individual agency and it's not these large historic forces. And there are libertarian, or pseudo-libertarian, narratives in which there were these large historic forces and we'd sort of definitively won these battles but that's not even true to the spirit of free markets or belief in individuals. There's always room for history, there's always room for new ideas, and these things are never definitively decided one way or the other.

Peter Robinson: All right, last question, and this touches on the notion of greatness that you were discussing a moment ago. George Kennan, "The issue of Soviet-American relations is in essence a test "of the overall worth of the United States. "To avoid destruction the United States need only "measure up to its own best traditions "and prove itself worthy of preservation as a great nation." Kennan writes that in 1951. If we replace the reference to the Soviet Union with a reference to China would you subscribe to that statement today?

Peter Thiel: Yes. I don't know, I'm always uncomfortable with saying it's a simple template though. So if we just go with the simple template, it's too automatic, and then if it's too automatic we're back in your Berlin tear down this wall speech, and then we've replaced the reference and we're, you know, we know China's the Soviet Union and because we say it's the Soviet Union we don't need to do anything else because we knew that just all happened on its own. And in practice the Cold War was won in very specific ways. There was sort of a whole series of concrete situations that you had to deal with, and the rivalry with China, it's somewhat different. It's happening in an Information Age, not an Industrial Age. There's sort of a global competition question. There's sort of a way in which the two economies are very deeply connected. We weren't deeply connected to the Soviet Union. So there are sort of a lot of things about it that are very different and I think, yeah, we have to, it's not like 2020 is like 1951, or like, you know, 1989. 2020 is like 2020 which is much less helpful but much more accurate.

Peter Robinson: Peter Thiel, thank you.

PETER M. ROBINSON

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Peter M. Robinson is the Murdoch Distinguished Policy Fellow at the Hoover Institution, where he writes about business and politics, edits Hoover's quarterly journal, the *Hoover Digest*, and hosts Hoover's video series program *Uncommon Knowledge*. After graduating summa cum laude in English from Dartmouth College, Robinson studied politics, philosophy, and economics at Oxford University. He then spent six years in the White House, serving as chief speechwriter to Vice President George H. W. Bush (1982–83) and as special assistant and speechwriter to President Ronald Reagan (1983–88). He wrote the historic Berlin Wall address in which Reagan called on Mikhail Gorbachev to "tear down this wall!"

After the White House, Robinson attended the Stanford University Graduate School of Business and graduated with an MBA in 1990. Robinson then spent a year at Fox Television, New York, reporting to Rupert Murdoch, and another year with the Securities and Exchange Commission, Washington, DC, where he served as the director of the Office of Public Affairs, Policy Evaluation, and Research. Robinson joined Hoover in 1993. In 2005, Robinson was elected to serve as a Trustee of Dartmouth College. Robinson has published numerous essays and interviews in the *New York Times*, *Red Herring*, *Forbes ASAP*, the *Wall Street Journal*, and *National Review Online*. He is the author of *How Ronald Reagan Changed My Life*; *It's My Party: A Republican's Messy Love Affair with the GOP*; and the best-selling business book *Snapshots from Hell: The Making of an MBA*. He is the editor of *Can Congress Be Fixed?: Five Essays on Congressional Reform*.

PETER THIEL

ENTREPRENEUR

Peter Thiel is an entrepreneur and investor. He cofounded PayPal, led it as CEO, and took it public; he made the first outside investment in Facebook, where he serves as a director; and he cofounded Palantir Technologies, where he serves as chairman. He has provided early funding for LinkedIn, Yelp, and dozens of startups, many run by former colleagues who have been dubbed the "PayPal Mafia."

Thiel is a partner at Founders Fund, a Silicon Valley venture-capital firm that has funded companies including SpaceX and Airbnb. He started the Thiel Fellowship, which funds young entrepreneurs, and he leads the Thiel Foundation, which works to advance technological progress and long-term thinking. He is also author of the no. 1 *New York Times* bestselling book *Zero to One: Notes on Startups, or How to Build the Future*.

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Victor Davis Hanson, Hoover Institution
Amity Shlaes, Calvin Coolidge Presidential Foundation
Robert Skidelsky, Warwick University
Niall Ferguson, Hoover Institution
Jesús Fernández-Villaverde, University of Pennsylvania
Douglas Ginsburg, Judget on the DC Circuit Court
Jeff Bennett, Australian National University
John Cochrane, Hoover Institution
Lars Peder Nordbakken, Civita, Norway
Paulo Guedes, Minister of Economy, Brazil
Anthony Kim, Heritage Foundation
Fred McMahon, Fraser Institute
Valeria Perotti, World Bank
John Cogan, Hoover Institution
Susan Dudley, George Washington University
Lars Feld, German Council of Economic Experts and the Eucken Institute
Ayaan Hirsi Ali, Hoover Institution
Samuel Gregg, Acton Institute
Bridgett Wagner, Heritage Foundation
Axel Kaiser, Executive Director, Foundation for Progress, Chile
Ernesto Silva, Former President, Independent Democratic Union Party, Chile
Arnold Harberger, University of California at Los Angeles
Terry Anderson, Hoover Institution
Lee Ohanian, University of California at Los Angeles
Russell Roberts, Hoover Institution
Jamie Borwick, House of Lords, United Kingdom
Tyler Goodspeed, U.S. Council of Economic Advisers
Ruth Richardson, former Finance Minister, New Zealand
Dominique Lazanski, Last Press Label
Joe Lonsdale, 8VC
Sally Pipes, Pacific Research Institute
Peter Thiel, Cofounder of PayPal and Palantir
Peter Robinson, Hoover Institution