Milton Friedman
CAPITALISM AND FREEDOM
The classic statement of Milton Friedman's economic philosophy
Introduction

In a much quoted passage in his inaugural address, President Kennedy said, "Ask not what your country can do for you ask what you can do for your country." It is a striking sign of the temper of our times that the controversy about this passage centered on its origin and not on its content. Neither half of the statement expresses a relation between the citizen and his government that is worthy of the ideals of free men in a free society. The paternalistic "what your country can do for you" implies that government is the patron, the citizen the ward, a view that is at odds with the free man's belief in his own responsibility for his own destiny. The organismic, "what you can do for your country" implies that government is the master or the deity, the citizen, the servant or the votary. To the free man, the country is the collection of individuals who compose it, not something over and above them. He is proud of a common heritage and loyal to common traditions. But he regards government as a means, an instrumentality, neither a grantor of favors and gifts, nor a master or god to be blindly worshipped and served. He recognizes no national goal except as it is the consensus of the goals that the citizens severally serve. He recognizes no national purpose except as it is the consensus of the purposes for which the citizens severally strive.

The free man will ask neither what his country can do for him nor what he can do for his country. He will ask rather "What can I and my compatriots do through government" to help us discharge our individual responsibilities, to achieve our several goals and purposes, and above all, to protect our freedom? And he will accompany this question with another: How can we keep the government we create from becoming a Frankenstein that will destroy the very freedom we establish it to protect? Freedom is a rare and delicate plant. Our minds tell us, and history confirms, that the great threat to freedom is the concentration of power. Government is necessary to preserve our freedom, it is an instrument through which we can exercise our freedom; yet by concentrating power in political hands, it is also a threat to freedom. Even though the men who wield this power initially be of good will and even though they be not corrupted by the power they exercise, the power will both attract and form men of a different stamp.

How can we benefit from the promise of government while avoiding the threat to freedom? Two broad principles embodied in our Constitution give an answer that has preserved our freedom so far, though they have been violated repeatedly in practice while proclaimed as precept.

First, the scope of government must be limited. Its major function must be to protect our freedom both from the enemies outside our gates and from our fellow-citizens: to preserve law and order, to enforce private contracts, to foster
competitive markets. Beyond this major function, government may enable us at times to accomplish jointly what we would find it more difficult or expensive to accomplish severally. However, any such use of government is fraught with danger. We should not and cannot avoid using government in this way. But there should be a clear and large balance of advantages before we do. By relying primarily on voluntary co-operation and private enterprise, in both economic and other activities, we can insure that the private sector is a check on the powers of the governmental sector and an effective protection of freedom of speech, of religion, and of thought.

The second broad principle is that government power must be dispersed. If government is to exercise power, better in the county than in the state, better in the state than in Washington. If I do not like what my local community does, be it in sewage disposal, or zoning, or schools, I can move to another local community, and though few may take this step, the mere possibility acts as a check. If I do not like what my state does, I can move to another. If I do not like what Washington imposes, I have few alternatives in this world of jealous nations.

The very difficulty of avoiding the enactments of the federal government is of course the great attraction of centralization to many of its proponents. It will enable them more effectively, they believe, to legislate programs that as they see it are in the interest of the public, whether it be the transfer of income from the rich to the poor or from private to governmental purposes. They are in a sense right. But this coin has two sides. The power to do good is also the power to do harm; those who control the power today may not tomorrow; and, more important, what one man regards as good, another may regard as harm. The great tragedy of the drive to centralization, as of the drive to extend the scope of government in general, is that it is mostly led by men of good will who will be the first to rue its consequences.

The preservation of freedom is the protective reason for limiting and decentralizing governmental power. But there is also a constructive reason. The great advances of civilization, whether in architecture or painting, in science or literature, in industry or agriculture, have never come from centralized government. Columbus did not set out to seek a new route to China in response to a majority directive of a parliament, though he was partly financed by an absolute monarch. Newton and Leibnitz; Einstein and Bohr; Shakespeare, Milton, and Pasternak; Whitney, McCormick, Edison, and Ford; Jane Addams, Florence Nightingale, and Albert Schweitzer; no one of these opened new frontiers in human knowledge and understanding, in literature, in technical possibilities, or in the relief of human misery in response to governmental directives. Their achievements were the product of individual genius, of strongly held minority views, of a social climate permitting variety and diversity.
Government can never duplicate the variety and diversity of individual action. At any moment in time, by imposing uniform standards in housing, or nutrition, or clothing, government could undoubtedly improve the level of living of many individuals; by imposing uniform standards in schooling, road construction, or sanitation, central government could undoubtedly improve the level of performance in many local areas and perhaps even on the average of all communities. But in the process, government would replace progress by stagnation, it would substitute uniform mediocrity for the variety essential for that experimentation which can bring tomorrow's laggards above today's mean.

This book discusses some of these great issues. Its major theme is 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 and a necessary condition for political freedom. Its minor theme is the role that government should play in a society dedicated to freedom and relying primarily on the market to organize economic activity.

The first two chapters deal with these issues on an abstract level, in terms of principles rather than concrete application. The later chapters apply these principles to a variety of particular problems.

An abstract statement can conceivably be complete and exhaustive, though this ideal is certainly far from realized in the two chapters that follow. The application of the principles cannot even conceivably be exhaustive. Each day brings new problems and new circumstances. That is why the role of the state can never be spelled out once and for all in terms of specific functions. It is also why we need from time to time to re-examine the bearing of what we hope are unchanged principles on the problems of the day. A by-product is inevitably a retesting of the principles and a sharpening of our understanding of them.

It is extremely convenient to have a label for the political and economic viewpoint elaborated in this book. The rightful and proper label is liberalism. Unfortunately, "As a supreme, if unintended compliment, the enemies of the system of private enterprise have thought it wise to appropriate its label," so that liberalism has, in the United States, come to have a very different meaning than it did in the nineteenth century or does today over much of the Continent of Europe.

As it developed in the late eighteenth and early nineteenth centuries, the intellectual movement that went under the name of liberalism emphasized freedom as the ultimate goal and the individual as the ultimate entity in the society. It supported laissez faire at home as a means of reducing the role of the
state in economic affairs and thereby enlarging the role of the individual; it supported free trade abroad as a means of linking the nations of the world together peacefully and democratically. In political matters, it supported the development of representative government and of parliamentary institutions, reduction in the arbitrary power of the state, and protection of the civil freedoms of individuals.

Beginning in the late nineteenth century, and especially after 1930 in the United States, the term liberalism came to be associated with a very different emphasis, particularly in economic policy. It came to be associated with a readiness to rely primarily on the state rather than on private voluntary arrangements to achieve objectives regarded as desirable. The catchwords became welfare and equality rather than freedom. The nineteenth-century liberal regarded an extension of freedom as the most effective way to promote welfare and equality; the twentieth-century liberal regards welfare and equality as either prerequisites of or alternatives to freedom. In the name of welfare and equality, the twentieth-century liberal has come to favor a revival of the very policies of state intervention and paternalism against which classical liberalism fought. In the very act of turning the clock back to seventeenth-century mercantilism, he is fond of castigating true liberals as reactionary!

The change in the meaning attached to the term liberalism is more striking in economic matters than in political. The twentieth-century liberal, like the nineteenth-century liberal, favors parliamentary institutions, representative government, civil rights, and so on. Yet even in political matters, there is a notable difference. Jealous of liberty, and hence fearful of centralized power, whether in governmental or private hands, the nineteenth-century liberal favored political decentralization. Committed to action and confident of the beneficence of power so long as it is in the hands of a government ostensibly controlled by the electorate, the twentieth-century liberal favors centralized government. He will resolve any doubt about where power should be located in favor of the state instead of the city, of the federal government instead of the state, and of a world organization instead of a national government.

Because of the corruption of the term liberalism, the views that formerly went under that name are now often labeled conservatism. But this is not a satisfactory alternative. The nineteenth-century liberal was a radical, both in the etymological sense of going to the root of the matter, and in the political sense of favoring major changes in social institutions. So too must be his modern heir. We do not wish to conserve the state interventions that have interfered so greatly with our freedom, though, of course, we do wish to conserve those that have promoted it. Moreover, in practice, the term conservatism has come to cover so wide a range of views, and views so incompatible with one another,
that we shall no doubt see the growth of hyphenated designations, such as libertarian-conservative and aristocratic-conservative.

Partly because of my reluctance to surrender the term to proponents of measures that would destroy liberty, partly because I cannot find a better alternative, I shall resolve these difficulties by using the word liberalism in its original sense as the doctrines pertaining to a free man.

Chapter XI
Social Welfare Measures

The humanitarian and egalitarian sentiment which helped produce the steeply graduated individual income tax has also produced a host of other measures directed at promoting the "welfare" of particular groups. The most important single set of measures is the bundle misleadingly labeled "social security." Others are public housing, minimum wage laws, farm price supports, medical care for particular groups, special aid programs, and so on.

I shall first discuss briefly a few of the latter, mostly to indicate how different their actual effects may be from those intended, and shall then discuss at somewhat greater length the largest single component of the social security program, old age and survivor's insurance.

Miscellaneous Welfare Measures

I. Public Housing One argument frequently made for public housing is based on an alleged neighborhood effect: slum districts in particular, and other low quality housing to a lesser degree, are said to impose higher costs on the community in the form of fire and police protection. This literal neighborhood effect may well exist. But insofar as it does, it alone argues, not for public housing, but for higher taxes on the kind of housing that adds to social costs since this would tend to equalize private and social cost.

It will be answered at once that the extra taxes would bear on low-income people and that this is undesirable. The answer means that public housing is proposed not on the ground of neighborhood effects but as a means of helping low-income people. If this be the case, why subsidize housing in particular? If funds are to be used to help the poor, would they not be used more effectively by being given in cash rather than in kind? Surely, the families being helped would rather have a given sum in cash than in the form of housing. They could themselves spend the money on housing if they so desired. Hence, they would never be worse off if given cash; if they regarded other needs as more important, they would be better off. The cash subsidy would solve the neighborhood effect as well as the subsidy in kind, since if it were not used to buy housing it would be available to pay extra taxes justified by the neighborhood effect.

Public housing cannot therefore be justified on the grounds either of neighborhood effects or of helping poor families. It can be justified, if at all, only on grounds of paternalism; that the families being helped "need" housing more than they "need" other things but would themselves either not agree or would
spend the money unwisely. The liberal will be inclined to reject this argument for responsible adults. He cannot completely reject it in the more indirect form in which it affects children; namely, that parents will neglect the welfare of the children, who "need" the better housing. But he will surely demand evidence much more persuasive and to the point than the kind usually given before he can accept this final argument as adequate justification for large expenditures on public housing.

So much could have been said in the abstract, in advance of actual experience with public housing. Now that we have had experience, we can go much farther. In practice, public housing has turned out to have effects very different indeed from those intended.

Far from improving the housing of the poor, as its proponents expected, public housing has done just the reverse. The number of dwelling units destroyed in the course of erecting public housing projects has been far larger than the number of new dwelling units constructed. But public housing as such has done nothing to reduce the number of persons to be housed. The effect of public housing has therefore been to raise the number of persons per dwelling unit. Some families have probably been better housed than they would otherwise have been those who were fortunate enough to get occupancy of the publicly built units. But this has only made the problem for the rest all the worse, since the average density of all together went up.

Of course, private enterprise offset some of the deleterious effect of the public housing program by conversion of existing quarters and construction of new ones for either the persons directly displaced or, more generally, the persons displaced at one or two removes in the game of musical chairs set in motion by the public housing projects. However, these private resources would have been available in the absence of the public housing program.

Why did the public housing program have this effect? For the general reason we have stressed time and again. The general interest that motivated many to favor instituting the program is diffuse and transitory. Once the program was adopted, it was bound to be dominated by the special interests that it could serve. In this case, the special interests were those local groups that were anxious to have blighted areas cleared and refurbished, either because they owned property there or because the blight was threatening local or central business districts. Public housing served as a convenient means to accomplish their objective, which required more destruction than construction.

Even so, "urban blight" is still with us in undiminished force, to judge by the growing pressure for federal funds to deal with it.
Another gain its proponents expected from public housing was the reduction of juvenile delinquency by improving housing conditions. Here again, the program in many instances had precisely the opposite effect, entirely aside from its failure to improve average housing conditions. The income limitations quite properly imposed for the occupancy of public housing at subsidized rentals have led to a very high density of "broken" families in particular, divorced or widowed mothers with children. Children of broken families are especially likely to be "problem" children and a high concentration of such children is likely to increase juvenile delinquency. One manifestation has been the very adverse effect on schools in the neighborhood of a public housing project. Whereas a school can readily absorb a few "problem" children it is very difficult for it to absorb a large number. Yet in some cases, broken families are a third or more of the total in a public housing project and the project may account for a majority of the children in the school. Had these families been assisted through cash grants, they would have been spread much more thinly through the community.

2. Minimum wage laws Minimum wage laws are about as clear a case as one can find of a measure the effects of which are precisely the opposite of those intended by the men of good will who support it. Many proponents of minimum wage laws quite properly deplore extremely low rates; they regard them as a sign of poverty; and they hope, by outlawing wage rates below some specified level, to reduce poverty. In fact, insofar as minimum wage laws have any effect at all, their effect is clearly to increase poverty. The state can legislate a minimum wage rate. It can hardly require employers to hire at that minimum all who were formerly employed at wages below the minimum. It is clearly not in the interest of employers to do so. The effect of the minimum wage is therefore to make unemployment higher than it otherwise would be. Insofar as the low wage rates are in fact a sign of poverty, the people who are rendered unemployed are precisely those who can least afford to give up the income they had been receiving, small as it may appear to the people voting for the minimum wage.

This case is in one respect very much like public housing. In both, the people who are helped are visible the people whose wages are raised; the people who occupy the publicly built units. The people who are hurt are anonymous and their problem is not clearly connected to its cause: the people who join the ranks of the unemployed or, more likely, are never employed in particular activities because of the existence of the minimum wage and are driven to even less remunerative activities or to the relief rolls; the people who are pressed ever closer together in the spreading slums that seem to be rather a sign of the need for more public housing than a consequence of the existing public housing.
A large part of the support for minimum wage laws comes not from disinterested men of good will but from interested parties. For example, northern trade unions and northern firms threatened by southern competition favor minimum wage laws to reduce the competition from the South.

3. Farm price supports Farm price supports are another example. Insofar as they can be justified at all on grounds other than the political fact that rural areas are over-represented in the electoral college and Congress, it must be on the belief that farmers on the average have low incomes. Even if this be accepted as a fact, farm price supports do not accomplish the intended purpose of helping the farmers who need help. In the first place, benefits arc, if anything, inverse to need, since they are in proportion to the amount sold on the market. The impecunious farmer not only sells less on the market than the wealthier farmer; in addition, he gets a larger fraction of his income from products grown for his own use, and these do not qualify for the benefits. In the second place, the benefits, if any, to farmers from the price-support program are much smaller than the total amount spent. This is clearly true of the amount spent for storage and similar costs which does not go to the farmer at all indeed the suppliers of storage capacity and facilities may well be the major beneficiaries. It is equally true of the amount spent to purchase agricultural products. The farmer is thereby induced to spend additional sums on fertilizer, seed, machinery, etc. At most, only the excess adds to his income. And finally, even this residual of a residual oversates the gain since the effect of the program has been to keep more people on the farm than would otherwise have stayed there. Only the excess, if any, of what they can earn on the farm with the price-support program over what they can earn off the farm, is a net benefit to them. The main effect of the purchase program has simply been to make farm output larger, not to raise the income per farmer.

Some of the costs of the farm purchase program are so obvious and well-known as to need little more than mention: the consumer has paid twice, once in taxes for farm benefit payments, again by paying a higher price for food; the farmer has been saddled with onerous restrictions and detailed centralized control; the nation has been saddled with a spreading bureaucracy. There is, however, one set of costs which is less well known. The farm program has been a major hindrance in the pursuit of foreign policy. In order to maintain a higher domestic than world price, it has been necessary to impose quotas on imports for many items. Erratic changes in our policy have had serious adverse effects on other countries. A high price for cotton encouraged other countries to enlarge their cotton production. When our high price led to an unwieldy stock of cotton, we proceeded to sell overseas at low prices and imposed heavy losses on the producers whom we had by our earlier actions encouraged to expand output. The list of similar cases could be multiplied.
Old Age and Survivor's Insurance

The "social security" program is one of those things on which the tyranny of the status quo is beginning to work its magic. Despite the controversy that surrounded its inception, it has come to be so much taken for granted that its desirability is hardly questioned any longer. Yet it involves a large-scale invasion into the personal lives of a large fraction of the nation without, so far as I can see, any justification that is at all persuasive, not only on liberal principles, but on almost any other. I propose to examine the biggest phase of it, that which involves payments to the aged.

As an operational matter, the program known as old age and survivor's insurance (OASI) consists of a special tax imposed on payrolls, plus payments to persons who have reached a specified age, of amounts determined by the age at which payments begin, family status, and prior earning record.

As an analytical matter, OASI consists of three separable elements:

1. The requirement that a wide class of persons must purchase specified annuities, i.e., compulsory provision for old age.

2. The requirement that the annuity must be purchased from the government; i.e., nationalization of the provision of these annuities.

3. A scheme for redistributing income, insofar as the value of the annuities to which people are entitled when they enter the system is not equal to the taxes they will pay.

Clearly, there is no necessity for these elements to be combined. Each individual could be required to pay for his own annuity; the individual could be permitted to purchase an annuity from private firms; yet individuals could be required to purchase specified annuities. The government could go into the business of selling annuities without compelling individuals to buy specified annuities and require the business to be self-supporting. And clearly the government can and does engage in redistribution without using the device of annuities.

Let us therefore consider each of these elements in turn to see how far, if at all, each can be justified. It will facilitate our analysis, I believe, if we consider them in reverse order.

1. Income redistribution. The present OASI program involves two major kinds of redistribution; from some OASI beneficiaries to others; from the general taxpayer to OASI beneficiaries.
The first kind of redistribution is primarily from those who entered the system relatively young, to those who entered it at an advanced age. The latter are receiving, and will for some time be receiving, a greater amount as benefits than the taxes they paid could have purchased. Under present tax and benefit schedules, on the other hand, those who entered the system at a young age will receive decidedly less.

I do not see any grounds liberal or other on which this particular redistribution can be defended. The subsidy to the beneficiaries is independent of their poverty or wealth; the man of means receives it as much as the indigent. The tax which pays the subsidy is a flat-rate tax on earnings up to a maximum. It constitutes a larger fraction of low incomes than of high. What conceivable justification is there for taxing the young to subsidize the old regardless of the economic status of the old; for imposing a higher rate of tax for this purpose on the low incomes than on the high; or, for that matter, for raising the revenues to pay the subsidy by a tax on payrolls?

The second kind of redistribution arises because the system is not likely to be fully self-financing. During the period when many were covered and paying taxes, and few had qualified for benefits, the system appeared to be self-financing and indeed to be having a surplus. But this appearance depends on neglecting the obligation being accumulated with respect to the persons paying the tax. It is doubtful that the taxes paid have sufficed to finance the accumulated obligation. Many experts assert that even on a cash basis, a subsidy will be required. And such a subsidy generally has been required in similar systems in other countries. This is a highly technical matter which we cannot and need not go into here and about which there can be honest differences of opinion.

For our purpose, it is enough to ask only the hypothetical question whether a subsidy from the general taxpayer could be justified if it is required. I see no grounds on which such a subsidy can be justified. We may wish to help poor people. Is there any justification for helping people whether they are poor or not because they happen to be a certain age? Is this not an entirely arbitrary redistribution?

The only argument I have ever come across to justify the redistribution involved in OASI is one that I regard as thoroughly immoral despite its wide use. This argument is that OASI redistribution on the average helps low-income people more than high-income people despite a large arbitrary element; that it would be better to do this redistribution more efficiently; but that the community will not vote for the redistribution directly though it will vote for it as part of a social security package. In essence, what this argument says is that the
community can be fooled into voting for a measure that it opposes by presenting the measure in a false guise. Needless to say, the people who argue this way are the loudest in their condemnation of "misleading" commercial advertising!1

2. Nationalization of the provision of required annuities Suppose we avoid redistribution by requiring each person to pay for the annuity he gets, in the sense of course, that the premium suffices to cover the present value of the annuity, account being taken both of mortality and interest returns. What justification is there then for requiring him to purchase it from a governmental concern? If redistribution is to be accomplished, clearly the taxing power of the government must be used. But if redistribution is to be no part of the program and, as we have just seen, it is hard to see any justification for making it part, why not permit individuals who wish to do so to purchase their annuities from private concerns? A close analogy is provided by state laws requiring compulsory purchase of automobile liability insurance. So far as I know, no state which has such a law even has a state insurance company, let alone compels automobile owners to buy their insurance from a government agency.

Possible economies of scale are no argument for nationalizing the provision of annuities. If they are present, and the government sets up a concern to sell annuity contracts, it may be able to undersell competitors by virtue of its size. In that case, it will get the business without compulsion. If it cannot undersell them, then presumably economies of scale are not present or are not sufficient to overcome other diseconomies of governmental operation.

One possible advantage of nationalizing the provision of annuities is to facilitate the enforcement of compulsory purchase of annuities. However, this seems a rather trivial advantage. It would be easy to devise alternative administrative arrangements, such as requiring individuals to include a copy of a receipt for premium payments along with their income tax returns; or having their employers certify to their having met the requirement. The administrative problem would surely be minor compared with that imposed by the present arrangements.

The costs of nationalization seem clearly to outweigh any such trivial advantage. Here, as elsewhere, individual freedom to choose, and competition of private enterprises for custom, would promote improvements in the kinds of contracts available, and foster variety and diversity to meet individual need. On the political level, there is the obvious gain from avoiding an expansion in the scale of governmental activity and the indirect threat to freedom of every such expansion.

Some less obvious political costs arise from the character of the present program. The issues involved become very technical and complex. The layman is
often incompetent to judge them. Nationalization means that the bulk of the "experts" become employees of the nationalized system, or university people closely linked with it. Inevitably, they come to favor its expansion, not, I hasten to add, out of narrow self-interest but because they are operating within a framework in which they take for granted governmental administration and are familiar only with its techniques. The only saving grace in the United States so far has been the existence of private insurance companies involved in similar activities.

Effective control by Congress over the operations of such agencies as the Social Security Administration becomes essentially impossible as a result of the technical character of their task and their near-monopoly of experts. They become self-governing bodies whose proposals are in the main rubber-stamped by Congress. The able and ambitious men who make their careers in them are naturally anxious to expand the scope of their agencies and it is exceedingly difficult to prevent them from doing so. If the expert says yea, who is there competent to say nay? So we have seen an increasing fraction of the population drawn into the social security system, and now that there remain few possibilities of expansion in that direction, we are seeing a move toward the addition of new programs, such as medical care.

I conclude that the case against the nationalization of the provision of annuities is exceedingly strong, not only in terms of liberal principles but even in terms of the values expressed by proponents of the welfare state. If they believe that the government can provide the service better than the market, they should favor a government concern to issue annuities in open competition with other concerns. If they are right, the government concern will prosper. If they are wrong, the welfare of the people will be advanced by having a private alternative. Only the doctrinaire socialist, or the believer in centralized control for its own sake, can, so far as I can see, take a stand on principle in favor of nationalization of the provision of annuities.

3. Compulsory Purchase of Annuities Having cleared away the underbrush, we are now ready to face the key issue: compelling individuals to use some of their current income to purchase annuities to provide for their old age.

One possible justification for such compulsion is strictly paternalistic. People could if they wished decide to do individually what the law requires them to do as a group. But they are separately short-sighted and improvident. "We" know better than "they" that it is in their own good to provide for their old age to a greater extent than they would voluntarily; we cannot persuade them individually; but we can persuade 51 per cent or more to compel all to do what is in their own good. This paternalism is for responsible people, hence docs not even have the excuse of concern for children or madmen.
This position is internally consistent and logical. A thoroughgoing paternalist who holds it cannot be dissuaded by being shown that he is making a mistake in logic. He is our opponent on grounds of principle, not simply a well-meaning but misguided friend. Basically, he believes in dictatorship, benevolent and maybe majoritarian, but dictatorship none the less.

Those of us who believe in freedom must believe also in the freedom of individuals to make their own mistakes. If a man knowingly prefers to live for today, to use his resources for current enjoyment, deliberately choosing a penurious old age, by what right do we prevent him from doing so? We may argue with him, seek to persuade him that he is wrong, but are we entitled to use coercion to prevent him from doing what he chooses to do? Is there not always the possibility that he is right and that we are wrong? Humility is the distinguishing virtue of the believer in freedom; arrogance, of the paternalist.

Few people are thoroughgoing paternalists. It is a position that is most unattractive if examined in the cold light of the day. Yet the paternalistic argument has played so large a role in measures like social security that it seems worth making it explicit.

A possible justification on liberal principles for compulsory purchase of annuities is that the improvident will not suffer the consequence of their own action but will impose costs on others. We shall not, it is said, be willing to see the indigent aged suffer in dire poverty. We shall assist them by private and public charity. Hence the man who does not provide for his old age will become a public charge. Compelling him to buy an annuity is justified not for his own good but for the good of the rest of us.

The weight of this argument clearly depends on fact. If 90 per cent of the population would become charges on the public at age 65 in the absence of compulsory purchase of annuities, the argument would have great weight. If only 1 per cent would, the argument has none. Why restrict the freedom of 99 per cent to avoid the costs that the other 1 per cent would impose on the community?

The belief that a large fraction of the community would become public charges if not compelled to purchase annuities owed its plausibility, at the time OASI was enacted, to the Great Depression. In every year from 1931 through 1940, more than one-seventh of the labor force was unemployed. And unemployment was proportionately heavier among the older workers. This experience was unprecedented and has not been repeated since. It did not arise because people were improvident and failed to provide for their old age. It was a consequence, as we have seen, of government mismanagement. OASI is a cure,
if cure it be at all, for a very different malady and one of which we have had no experience.

The unemployed of the 1930's certainly created a serious problem of the relief of distress, of many people becoming public charges. But old-age was by no means the most serious problem. Many people in productive ages were on the relief or assistance rolls. And the steady spread of OASI, until today more than sixteen million persons receive benefits, has not prevented a continued growth in the number receiving public assistance.

Private arrangements for the care of the aged have altered greatly over time. Children were at one time the major means whereby people provided for their own old age. As the community became more affluent, the mores changed. The responsibilities imposed on children to care for their parents declined and more and more people came to make provision for old age in the form of accumulating property or acquiring private pension rights. More recently, the development of pension plans over and above OASI has accelerated. Indeed, some students believe that a continuation of present trends points to a society in which a large fraction of the public scrimps in their productive years to provide themselves with a higher standard of life in old age than they ever enjoyed in the prime of life. Some of us may think such a trend perverse, but if it reflects the tastes of the community, so be it.

Compulsory purchase of annuities has therefore imposed large costs for little gain. It has deprived all of us of control over a sizable fraction of our income, requiring us to devote it to a particular purpose, purchase of a retirement annuity, in a particular way, by buying it from a government concern. It has inhibited competition in the sale of annuities and the development of retirement arrangements. It has given birth to a large bureaucracy that shows tendencies of growing by what it feeds on, of extending its scope from one area of our life to another. And all this, to avoid the danger that a few people might become charges on the public.
Another current example of the same argument is in connection with proposals for federal subsidies for schooling (misleadingly labeled, "aid to education"). A case can be made for using federal funds to supplement schooling expenditures in the states with the lowest incomes, on the grounds that the children schooled may migrate to other states. There is no case whatsoever for imposing taxes on all the states and giving federal subsidies to all the states. Yet every bill introduced into Congress provides for the latter and not the former. Some proponents of these bills, who recognize that only subsidies to some states can be justified, defend their position by saying that a bill providing only for such subsidies could not be passed and that the only way to get disproportionate subsidies to poorer states is to include them in a bill providing subsidies to all states.
Chapter XII
The Alleviation of Poverty

The extraordinary economic growth experienced by Western countries during the past two centuries and the wide distribution of the benefits of free enterprise have enormously reduced the extent of poverty in any absolute sense in the capitalistic countries of the West. But poverty is in part a relative matter, and even in these countries, there are clearly many people living under conditions that the rest of us label as poverty.

One recourse, and in many ways the most desirable, is private charity. It is noteworthy that the heyday of laissez-faire, the middle and late nineteenth century in Britain and the United States, saw an extraordinary proliferation of private eleemosynary organizations and institutions. One of the major costs of the extension of governmental welfare activities has been the corresponding decline in private charitable activities.

It can be argued that private charity is insufficient because the benefits from it accrue to people other than those who make the gifts. Again, a neighborhood effect. I am distressed by the sight of poverty; I am benefited by its alleviation; but I am benefited equally whether I or someone else pays for its alleviation; the benefits of other people's charity therefore partly accrue to me. To put it differently, we might all of us be willing to contribute to the relief of poverty, provided everyone else did. We might not be willing to contribute the same amount without such assurance. In small communities, public pressure can suffice to realize the proviso even with private charity. In the large impersonal communities that are increasingly coming to dominate our society, it is much more difficult for it to do so.

Suppose one accepts, as I do, this line of reasoning as justifying governmental action to alleviate poverty; to set, as it were, a floor under the standard of life of every person in the community. There remain the questions, how much and how. I see no way of deciding "how much" except in terms of the amount of taxes we by which I mean the great bulk of use are willing to impose on ourselves for the purpose. The question, "how," affords more room for speculation.

Two things seem clear. First, if the objective is to alleviate poverty, we should have a program directed at helping the poor. There is every reason to help the poor man who happens to be a farmer, not because he is a farmer but because he is poor. The program, that is, should be designed to help people as people not as members of particular occupational groups or age groups or wage-rate groups or labor organizations or industries. This is a defect of farm programs, general old-age benefits, minimum-wage laws, pro-union legislation,
tariffs, licensing provisions of crafts or professions, and so on in seemingly endless profusion. Second, so far as possible the program should, while operating through the market, not distort the market or impede its functioning. This is a defect of price supports, minimum-wage laws, tariffs and the like.

The arrangement that recommends itself on purely mechanical grounds is a negative income tax. We now have an exemption of $600 per person under the federal income tax (plus a minimum 10 per cent flat deduction). If an individual receives $100 taxable income, i.e., an income of $100 in excess of the exemption and deductions, he pays a tax. Under the proposal, if his taxable income minus $100, i.e., $100 less than the exemption plus deductions, he would pay a negative tax, i.e., receive a subsidy. If the rate of subsidy were, say, 50 per cent, he would receive $50. If he had no income at all, and, for simplicity, no deductions, and the rate were constant, he would receive $300. He might receive more than this if he had deductions, for example, for medical expenses, so that his income less deductions, was negative even before subtracting the exemption. The rates of subsidy could, of course, be graduated just as the rates of tax above the exemption are. In this way, it would be possible to set a floor below which no man’s net income (defined now to include the subsidy) could fall in the simple example $300 per person. The precise floor set would depend on what the community could afford.

The advantages of this arrangement are clear. It is directed specifically at the problem of poverty. It gives help in the form most useful to the individual, namely, cash. It is general and could be substituted for the host of special measures now in effect. It makes explicit the cost borne by society. It operates outside the market. Like any other measures to alleviate poverty, it reduces the incentives of those helped to help themselves, but it does not eliminate that incentive entirely, as a system of supplementing incomes up to some fixed minimum would. An extra dollar earned always means more money available for expenditure.

No doubt there would be problems of administration, but these seem to me a minor disadvantage, if they be a disadvantage at all. The system would fit directly into our current income tax system and could be administered along with it. The present tax system covers the bulk of income recipients and the necessity of covering all would have the by-product of improving the operation of the present income tax. More important, if enacted as a substitute for the present rag bag of measures directed at the same end, the total administrative burden would surely be reduced.

A few brief calculations suggest also that this proposal could be far less costly in money, let alone in the degree of governmental intervention involved, than our present collection of welfare measures. Alternatively, these calculations
can be regarded as showing how wasteful our present measures are, judged as measures for helping the poor.

In 1961, government amounted to something like $33 billion (federal, state, and local) on direct welfare payments and programs of all kinds: old age assistance, social security benefit payments, aid to dependent children, general assistance, farm price support programs, public housing, etc. I have excluded veterans' benefits in making this calculation. I have also made no allowance for the direct and indirect costs of such measures as minimum-wage laws, tariffs, licensing provisions, and so on, or for the costs of public health activities, state and local expenditures on hospitals, mental institutions, and the like.

There are approximately 57 million consumer units (unattached individuals and families) in the United States. The 1961 expenditures of $33 billion would have financed outright cash grants of nearly $6,000 per consumer unit to the 10 per cent with the lowest incomes. Such grants would have raised their incomes above the average for all units in the United States. Alternatively, these expenditures would have financed grants of nearly $3,000 per consumer unit to the 20 per cent with the lowest incomes. Even if one went so far as that one-third whom New Dealers were fond of calling ill-fed, ill-housed, and ill-clothed, 1961 expenditures would have financed grants of nearly $2,000 per consumer unit, roughly the sum which, after allowing for the change in the level of prices, was the income which separated the lower one-third in the middle 1930's from the upper two-thirds. Today, fewer than one-eighth of consumer units have an income, adjusted for the change in the level of prices, as low as that of the lowest third in the middle 1930's.

Clearly, these are all far more extravagant programs than can be justified to "alleviate poverty" even by a rather generous interpretation of that term. A program which supplemented the incomes of the 20 per cent of the consumer units with the lowest incomes so as to raise them to the lowest income of the rest would cost less than half of what we are now spending.

The major disadvantage of the proposed negative income tax is its political implications. It establishes a system under which taxes are imposed on some to pay subsidies to others. And presumably, these others have a vote. There is always the danger that instead of being an arrangement under which the great majority tax themselves willingly to help an unfortunate minority, it will be converted into one under which a majority imposes taxes for its own benefit on an unwilling minority. Because this proposal makes the process so explicit, the danger is perhaps greater than with other measures. I see no solution to this problem except to rely on the self-restraint and good will of the electorate.
Writing about a corresponding problem British old-age pensions in 1914, Dicey said, "Surely a sensible and a benevolent man may well ask himself whether England as a whole will gain by enacting that the receipt of poor relief, in the shape of a pension, shall be consistent with the pensioner's retaining the right to join in the election of a Member of Parliament."\(^2\)

The verdict of experience in Britain on Dicey's question must as yet be regarded as mixed. England did move to universal suffrage without the disfranchisement of either pensioners or other recipients of state aid. And there has been an enormous expansion of taxation of some for the benefit of others, which must surely be regarded as having retarded Britain's growth, and so may not even have benefited most of those who regard themselves as on the receiving end. But these measures have not destroyed, at least as yet, Britain's liberties or its predominantly capitalistic system. And, more important, there have been some signs of a turning of the tide and of the exercise of self-restraint on the part of the electorate.

Liberalism and Egalitarianism

The heart of the liberal philosophy is a belief in the dignity of the individual, in his freedom to make the most of his capacities and opportunities according to his own lights, subject only to the proviso that he not interfere with the freedom of other individuals to do the same. This implies a belief in the equality of men in one sense; in their inequality in another. Each man has an equal right to freedom. This is an important and fundamental right precisely because men are different, because one man will want to do different things with his freedom than another, and in the process can contribute more than another to the general culture of the society in which many men live.

The liberal will therefore distinguish sharply between equality of rights and equality of opportunity, on the one hand, and material equality or equality of outcome on the other. He may welcome the fact that a free society in fact tends toward greater material equality than any other yet tried. But he will regard this as a desirable by-product of a free society, not its major justification. He will welcome measures that promote both freedom and equalitysuch as measures to eliminate monopoly power and to improve the operation of the market. He will regard private charity directed at helping the less fortunate as an example of the proper use of freedom. And he may approve state action toward ameliorating poverty as a more effective way in which the great bulk of the community can achieve a common objective. He will do so with regret, however, at having to substitute compulsory for voluntary action.

The egalitarian will go this far, too. But he will want to go further. He will defend taking from some to give to others, not as a more effective means
whereby the "some" can achieve an objective they want to achieve, but on grounds of "justice." At this point, equality comes sharply into conflict with freedom; one must choose. One cannot be both an egalitarian, in this sense, and a liberal.

1 This figure is equal to government transfer payments ($31.1 billion) less veterans' benefits ($4.8 billion), both from the Department of Commerce national income accounts, plus federal expenditures on the agricultural program ($5.5 billion) plus federal expenditures on public housing and other aids to housing ($0.5 billion), both for year ending June 30, 1961 from Treasury accounts, plus a rough allowance of $0.7 billion to raise it to even billions and to allow for administrative costs of federal programs, omitted state and local programs, and miscellaneous items. My guess is that this figure is a substantial underestimate.