A SPECIAL MEETING

THE MONT PELERIN SOCIETY

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

CHAPTER ONE

WHY CHOOSE ECONOMIC FREEDOM?

GEORGE P. SHULTZ & JOHN B. TAYLOR

HOOVER INSTITUTION • STANFORD UNIVERSITY

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).

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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.

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