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- Hello, this is William Clark of the Chicago Tribune welcoming you again on behalf of Instructional Dynamics to another visit with the distinguished economist Professor Milton Friedman of the University of Chicago. Dr Friedman, I think we should update ourselves on the money supply today. Oh I should mention too that we're recording this interview on Wednesday morning March 20th 1974. Milton perhaps we should update ourselves on the money stock.

- Perhaps before we do that I can reverse things on you today, Bill, and make you the person who answers the questions, and myself the one who asks them. For the benefit of our subscribers, William Clark is not only executive at the Chicago Tribune, not only the former editor of the, financial editor of the Chicago Tribune, but he's also this year's president of the Executive Club of Chicago. That's interesting because the Executive Club of Chicago served as host for President Nixon last Friday at a question and answer session in Chicago that was televised locally, widely reported around the country. And I thought it might be interesting, that our subscribers might be interested in getting something of a head table view of what such an occasion is like and what President Nixon's attitude, demeanor and state of mind and heart seem to be as viewed by the man who introduced him and actively participated in all of the arrangements. What was your general reaction Bill to the president's appearance?

- Why he seemed to be in very good spirits Milton. I thought he enjoyed himself throughout the session. He comes through, I think in the flesh more effectively than he does on television. I of course watched him as you did last night in a program televised from Houston. And to me he seemed a little bit tense though he responded very effectively, I thought to the questions, and covered a good deal of the same ground that he covered in his session here in Chicago. But in the flesh, in person he seemed to be in very good spirits, in good health, and I thought he enjoyed himself and the audience certainly enjoyed him.

- Well, Mr Nixon of course is a fascinating personality from this point of view. Everybody who has known him has recognized that he is not a simple person, that when you speak in the flesh, that also depends on in the flesh in a small intimate group and in the flesh in a big large gathering. In the flesh in a small intimate group, Mr Nixon comes across in a very different way also than he does in a large public gathering.

- I suppose you would know.

- Yes my own experience and evidence of that is that he is a much more relaxed man, I take leave to say a far more attractive person in personal connections because there isn't that tenseness, there isn't that attempt to make a public impression. Now this is true of all public figures who are always schizophrenic in a sense, they are always one thing for their public image and one thing for their private image. But I believe that the difference here is very much greater for Mr Nixon than it has been for most. One of the thing that has always interested me, I don't know how to fit this together is that in the public appearances when I've heard Mr Nixon on radio, rather than on television, it always seems to me it comes across much more favorable to him than the television appearance. And you know this was a record going way back to the 1960 period when the Nixon Kennedy debates were held.

- Yes.

- I know I had some friends at that time who were in Chile. Our university had a project in Chile at that time. And they heard the debates by short wave radio in Chile. And one and all, they were convinced that Mr Nixon had just wiped out Mr Kennedy, that there was no question about who had won.

- Is that so?

- On the other hand, the reaction to the television debate at home was precisely the opposite. Well now similarly, you're making the same contrast between seeing him in the flesh in a public appearance. There was no hostility I take it there on the part of the audience?

- No there wasn't Milton. There was one questioner, asked a question which had to do with impeachment and he mentioned that he said, would it be better for you to resign now? And there was just a brief burst of booing from one small section of the audience. And the president came in very rapidly and he said "no." He says "that's a perfectly proper question." Says "this is an interesting subject "and I should discuss it." And he went ahead to discuss it. One of the interesting things to me was that in our session here in Chicago there were 14 questions asked in this approximately hour long broadcast. The audience was generally described as friendly. It was enthusiastic. And some of the newspaper accounts afterwards, talking about his appearance in Houston said that in Houston, he will be questioned by radio and television news people. And this is being arranged to avoid the puff questions which were asked in Chicago. Well, so we went to Houston last night and he was questioned by newscasters. And the interesting thing was they covered exactly the same ground (laughing) that was covered here in Chicago. They were asked in a little more annoying way once or twice, but it was the same subject matter.

- What I think Houston brought out is a very different thing that I think is also of great importance, but not necessarily about Mr Nixon, but about the state of, of the American politic, the people in Houston, for in the main, represented the small independent broadcasting stations around the country.

- That's true.

- The enormous contrast between the questions asked by Mr Rather and Mr Brokaw reflects the sharp difference between the networks on the one hand, and the independent stations on the other. And the people from the independent stations who asked the questions, if the questions asked in Chicago were puff questions, I don't know how you would describe these. (laughing)
These were, if anything, much more--

- Yes they were.

- Puff questions.

- That's true.

- The extraordinary thing is as it illustrates, what a enormous role for good or for bad is played in the shaping of public opinion by those three networks, plus two newspapers, the Washington Post and the New York Times.

- That's right. Oh I felt that he did very well here in Chicago and I felt that he made some points. I think generally this is a good thing for him to be doing.

- Oh I am sure it is because there is no doubt that he is an extraordinarily able man. There is no doubt whatever may be, the merits or demerits of the Watergate issue. There is no doubt it has been blown up out of all proportion from the point of view of any perspective, any sense of perspective. If you consider the amount of attention which has been devoted to this by comparison with the situation in the United States three or four years ago when the Vietnam War was in full flight when we had disturbances on campuses that were threatening to tear down the universities and the institutions, Watergate is not anything to be condoned, far from it. But it's of a different order of magnitude than those earlier kinds of events and yet, it has been built up into, have at least the same importance in the public mind.

- Yes it's true.

- Maybe we ought--

- I'm afraid--

- Turn the time back to you Bill and reverse the order again?
(laughing)

- All right. I think the subscribers are much more interested I what Professor Milton Friedman has to say about the economy. I noticed the story or this article by Alan Greenspan in the Wall Street Journal yesterday morning and I tore it out and I'm going to read one sentence of it, I thought it might be a good peg for some commentary by you. He says we now need a higher rate of return and a higher proportion of the national income going to profits if we are to generate sufficient capitol expenditures to maintain the aggregate growth and real income of which we are capable. This is just one sentence in a longer article which I know you read. But I would be interested in your comment.

- Well I think the point that Alan Greenspan makes is an extremely interesting and important point. What he is saying is that thanks to the enormous growth of governmental intervention of various kinds, the risks involved in capitol investment are higher. Now let me warn immediately against one interpretation of the sentence you read which Alan Greenspan I'm sure does not intend, but which is easily drawn from it. There is a tendency to argue, and some of the oil companies have argued this way, that they need larger profits in order to provide the finance, the direct finance for their investments, that the profits are gonna be the source of plowback. That's not what Greenspan has in mind. He means they need larger profits in order to show a higher rate of return, in order to attract the savings of the public at large to make it advantageous for the public at large to invest in the enterprise. After all, this is a tendency to think in terms of companies, the expected rate of return which most companies would require to initiate capitol expenditures. Now the companies don't require any rate of return. What's important is what rate of return do people who hold stock in those companies, or people who are going to lend money to those companies in the form of bonds, what rate of return do they require in order to make it profitable to them, to invest in those enterprises. And it seems to me there isn't doubt that Mr Greenspan is completely correct in saying that the greater uncertainty which now prevails requires a greater rate of return. As I have emphasized on earlier tapes, I think there's another aspect of that which underlies what which Mr Greenspan has said, but which he hasn't brought out, which also involves requiring a higher expected rate of return. And this is not only governmental intervention in the direct form of price control or wage control or, to take a particular example out of the newspapers the other day, the Interstate Commerce Commission ordering railroads to provide certain freight cars down in Florida. Now you stop and think about that wording for a moment, and ask what would it mean to say that the government orders you to provide certain machines somewhere? In the next stage orders you to provide your services, your labor services somewhere? But at any rate, it's not only that kind of thing. But it is also the change in the rules about property ownership and corporate responsibility in a legal sense, which it made corporate ownership a much less attractive thing. I think a very basic element is the shift in the doctrine of legal responsibility, from a doctrine that was almost wholly caveat emptor, buyer beware, in which the producer was responsible only for fraud or deliberate misstatements of the character of his product. We have shifted to a situation almost of not caveat emptor but vendor emptor, seller beware, in which the seller is liable for damages, even though the damages that occurred were not attributable in any way to the seller's negligence or lack of responsibility. The only thing that has been offsetting that in one way or another has been that it should be noted that the federal government is a partner in most of these risks. If you take a typical corporation which is paying something like a 50% tax rate, the federal government shares, to the extent of 50% of the profits and 50% in the losses. But that doesn't alter the wide diversity of losses. Now is there any chance, says Mr Greenspan in essence that we're going to move in the direction that seems to be required toward higher rate of return? It is very dubious. This is another example of the extent to which governmental measures so often have the opposite of the effect that they are intended to have. Much of the drive against corporations has been sparked by the widespread misconception that they are profiteers who are earning unconscionable rates of return. And the effect of that drive is going to be to drive up the rates of return. It will drive up the rates of return, precisely because people will not be willing to invest in those forms, and as a result, the rate of return will go up higher. There's another aspect of this however which Mr Greenspan does not mention but which is equally important from this point of view. You need high rates of return to attract the capitol. But also, you need the capitol to be attractive to savings. That consists of two parts. It consists of the willingness of people to save, but it also consists of other demands upon that capitol. Now if you look at what has been happening, the federal government has increasingly been levying heavy demands on that capitol. On the one hand the deficits of the federal government involve a demand on that capitol. But even if the federal government were to go into a even balance, the government, federal government, through all sorts of back door agencies, agencies governmentally guaranteed, non-guaranteed, independently set-up corporations and so on, all of which are governmental like Amtrak, like the various housing agencies and so on has in that way been levying heavy demands upon the capitol market. Some estimates which I have seen suggest that in the next year or two, something like half of total savings of the United States will be absorbed in these governmental ventures. Well that only leaves the other half for the investment in the kind of thing that Mr Greenspan is talking about. Thus it is very hard to avoid the conclusion that so far as capitol investment and expenditures are concerned over the next few years, you will see higher real rates of return, profit required, but you will see lower levels of productive addition to the capitol stock of the country. And hence there is a real question about whether the kind of easy assumption that has been made, that sort of the natural inherent rate of growth, of the real output of the country, something like four and a quarter percent, I think there is a real reason to question whether the United States will be able to maintain a rate of growth of that kind unless we have a drastic change in some of these policies.

- What does that say about the long-term attractiveness in investment in the stock market despite present prices?

- So far as the stock market is concerned, presumably this prospect, if it's widely anticipated, is one of the reasons why stock market prices are as low as they are now. There's no reason why stock market prices should not pull up. But what it does say is that anybody who expects that there is going to be another great revaluation of price earnings ratios, as you realize, we went through a phase after the war when price earnings ratios were revised drastically upward. More recently, in the last five years, we've been going through a phase in which they were revised drastically downward. Now, that downward revision probably reflects the kinds of forces that Mr Greenspan is talking about and those that I have been mentioning now. And therefore it does not suggest that over the long pull there is likely to be any substantial revision of price earnings ratios upward hence that would suggest that the stock market will rise, on the one hand, because of inflation, on the other hand because of the growth of the economy. But not in any real long run bull market, unless there is a change in these governmental policies.

- I see. Milton it's been a few sessions since you updated us on the money stock, perhaps you could do that now and comment on the seeming paradox of little increase in the money supply accompanied by an increase of interest rates.

- That is kind of interesting. I was really taken aback by the headline in the Wall Street Journal story at the end of last week Friday when the money supply was announced saying "Rapid growth in money supply "spurs increase in rate of interest." Every textbook in economics would argue rightly or wrongly the opposite relationship. And ordinarily people would say well if the money supply is increasing rapidly, doesn't that drive down the rate of interest? Well the answer is, of course, historic traditionally, and over any rate of time, as we know, a rabid increase in the money supply temporarily does drive down the rate of interest. But over a longer period of time raises the rate of interest by providing the basis for inflation which gets built into the interest rate. And what this shows in the market is that participants in the market are pretty smart. And they have been learning their lesson. And they have been learning, of course, I may say what the Wall Street Journal said in explaining it was that the reason it drove up the interest rates was that because of the rapid rise, it was believed that the Federal Reserve would have to turn around and offset that, and therefore the market was anticipating a future slowdown in the rate of monetary growth.

(laughing) Well you can't have that both ways. Because the future slowdown in the rate of monetary growth will not raise future interest rates unless the present abnormal increase lowered them in the first place. So if the abnormal increase raises them, there's nothing to be offset later on! (laughing) So that explanation is not very logical. And I think really the more fundamental explanation is very different. I think the more fundamental explanation which has been developing over the past few years, so it's not, this is not something new. But I have been very much impressed over the past few years that this temporary depressing effect on interest rates and more rapid rates of growth, the money supply which was very consistent for many years, about a six or nine months effect shows up much less strongly in the past few years. This lag has been shortening because the market has been learning and therefore it has been reacting immediately to what the long term effect will be rather than the short term effect. Now that rapid increase in the money supply is in the last, that week, was another very erratic move. The thing you have to say about the money supply as reported in the papers which is mostly M1, currency and demand department, over the past year, year and half is that it has been very erratic. It has fluctuated rather widely, the rate of growth. You had a period in early 1973 from about April to June 1973 in which the money supply was rising at a horrendous rate. Then you had a period from June to October in which the money supply was declining. Since October it's been rising again at rates of about seven or eight percent on the average over that period. And the week to week gyrations have been quite marked. So that it is very hard from the statistical picture to draw any very precise inference about the behavior of the money supply. My own judgment is that if you look at that M1, the best way to describe it is that on the whole over several years now it has been rising at a rate of something like six percent or maybe a little more. Whenever the money supply has risen substantially above that, the Fed has drawn back down under it, whenever it's gotten below it the Fed has been increasing it. In the past couple of months, it looks as if you have started on a fairly rapid increase, you're now headed to be above that six percent rate. If you look at the money stock M2 figures, including time deposits other than large CDs, that series also shows some of these same gyrations but it's a much steadier series. There's much fewer of these gyrations and I think it's easier to read. Now that series is easily described. That series is described by saying you will have not far from a 10% rate of growth from there for quite a long time. Certainly if you take the rate of change over the last four months, it's been over about, a little over 10%, 10 and a half percent. If you take it over the last year, it's been about nine percent. So that with respect to the M2 definition, nine to 10 percent, average rate of growth is a reasonable interpretation. Again, there is a little sign that if anything, the rate of growth has speeded up in the last month or two. Now, let me translate those into implications. The 10% rate of growth in M2 implies roughly a 10% rate of growth in the nominal GNP. That implies with price increases of the order of seven, eight to nine percent in GNP it implies real rates of growth of one to two to three percent in GNP. And as you know we are now having a very distinct slow down and I suspect that will continue for a time. One other thing I might say along these lines is that the political pressure on the Federal Reserve to avoid a recession, to validate Mr Nixon's pledge that there will be no recession is undoubtedly one of the factors that is tending to keep the rate of the growth of the money supply up even though the Federal Reserve is nominally independent, and even though Mr Burns has stated over and over again that the Federal Reserve will not, itself, be the architect of a continued increase in the rate of inflation.

- That suggests a point that some people try to make to the effect that inflation is politically acceptable but unemployment is not, do you go along with that?

- That's always been, that's been the standard view. And there is no doubt that that is a view of Mr Nixon. It was the view of Mr Edward Heath of Britain, of almost every other politician around the world. The interesting thing about it is the recent experience suggests that maybe that view isn't as clear as it might seem. If you ask yourself what has been the major source of the political problems all over the world, of the major leaders, in every single case in the past year or two it's been the public reaction against inflation. Why was Mr Heath in such great trouble in Britain? What happened, Mr Heath's example is a perfect example. He started out and came into his latest term of office with a pledge that he was gonna end price and wage control and end inflation. He started along the right line but when unemployment reached a million, on the basis of the political judgment you just expressed, he decided he couldn't stand it anymore, he stepped on the gas, poured in money, increased government expenditures, and after it broke out into inflation, tried to stop it by price and wage controls which had the usual effect, he's out of office now. Here is Mr Tanaka in Japan came in as a very popular prime minister. The rate of inflation in Japan, they hope they can hold it down to 20% this year. They're at that level. Mr Tanaka is in deep trouble. The public opinion polls have him as low as, or lower than Mr Nixon in this country. In the United States, what has been the source of the greatest public annoyance in the past year, it's been inflation. Now it's interesting, as I think I reported on one of these tapes, my colleague George Stigler, a little while ago did an interesting statistical regression analysis of the relationship between results in congressional elections and on the one hand unemployment, and on the other inflation. And what he asked was under what circumstances do incumbents get turned out? It wasn't a party thing Democrats and Republicans. And much to his surprise he found that the level of unemployment seemed to have no effect but the rate of inflation had a significant effect in turning out incumbents. So it may be that this widely believed political wisdom which is undoubtedly a heritage from the Great Depression of the 1930s, may be wrong. If that is so, it perhaps is a most hopeful sign. Because if it becomes in the self-interest of politicians to stop inflation, inflation will be stopped.

- Thank you very much. We've been visiting with Professor Milton Friedman of the University of Chicago. If the subscribers would like to suggest subjects for Dr Friedman to discuss on future tapes or pose questions for him to answer, please write to Instructional Dynamics Incorporated 166 East Superior Street, Chicago Illinois, 60611. We'll be talking with Dr Friedman a couple of weeks hence.