

COMMANDING HEIGHTS

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A former faculty member at the University of Chicago and economic advisor to Presidents Eisenhower and Nixon, George Shultz was appointed secretary of state in Ronald Reagan's Cabinet in 1982.

Shultz discusses his role in the Cold War as a member of the Reagan administration and offers his views on the Chicago School of economic thought and the Nixon and Reagan years.

Investigating the TVA

INTERVIEWER: What was the subject of the thesis you wrote in your university years, and what did you learn from it?

GEORGE SHULTZ: At Princeton, undergraduates have to write a thesis, and it's a wonderful requirement. Mine was on the agricultural program of the Tennessee Valley Authority, the TVA, which was all the rage [in those days].... And I spent a summer in the Tennessee Valley gathering material myself. I went to Washington and I went to Knoxville, I gathered all the statistical information.

And then I went and lived for two weeks with a hillbilly family—so-called hillbillies—and I learned some very interesting things from that visit. The hillbillies understood the government programs very well. They knew what the government wanted to have reported, and if they reported certain things they realized that would cause the government to give them fertilizer that they needed. So it took me a long while to gain their confidence, but I discovered that they reported what the government wanted to hear, whether it was actually the case or not, because they understood how to game the system.

So I said to myself, "Here I've been looking at these statistics. The statistics are just an agglomeration of all of these individual reports, and now I've learned that the reports themselves are the product of the system rather than the actual facts on the ground." So I learned a great deal about statistics. And I realized that if you go to primary sources, you're going to be better off.

That's one of the reasons why I feel very proud of the Hoover Institution where I reside because it has a speciality, it has wonderful archival material, and people come here because that material is the primary data that you get, not secondary data.

INTERVIEWER: Did that sort of undermine your confidence in things like the New Deal policies at that time?

GEORGE SHULTZ: No, it didn't undermine my confidence. I had a lot of skepticism about the TVA, but nevertheless I picked out this little segment of it to study and I think that one would have to say that the dams did do what they were supposed to do. The dams controlled flooding, they gave a chance for agriculture to flourish, and it was a good thing, if costly.

INTERVIEWER: Could it have been done better, some other way?

GEORGE SHULTZ: Probably, but I didn't dig into that.

The Chicago School and Its Impact

INTERVIEWER: In the '50s, '60s, and '70s, people were talking about the Chicago School of economics and politics. What did that phrase come to stand for?

GEORGE SHULTZ: Well, it stands for the fundamental value of freedom and, of course, in the economics realm it's free markets, freedom of enterprise, freedom from undue regulation. So [it stands for] all of those kinds of things, I think.

INTERVIEWER: Why did the Chicago School sort of equate free markets with personal freedom, or political freedom? What's the connection?

GEORGE SHULTZ: I think they are equated in the sense that if you have a society that doesn't put any value on personal freedom, it's going to be hard for that society to have genuinely free markets. And I think as societies try to have free markets without more individual freedom, what happens over time is that the market pushes into the political system and changes it, as we have seen on a number of instances.

INTERVIEWER: Where have you seen that?

GEORGE SHULTZ: Well, for example in Chile we had a regime with a prime minister named [Allende], which was governmentalizing the Chilean system, and the economic system was declining and in disarray. At the request of the Chilean legislator, the armed forces took over and no doubt did some unnecessarily brutal things in the process, but nevertheless they took over and I think didn't know quite what to do about the economy. So there were in Chile some people who came to be called Chicago Boys, they had studied economics at the University of Chicago. And when the cry went out "What shall we do?" they raised their hands and said, "We know what to do." And so a Chicago School-like economy gradually evolved in Chile. It worked. They had the only decent economy in South America in the mid-80s and on. Over time, I think it had its impact on the political system. We did see, in the end, a peaceful transition to a democracy and general Pinochet, to his credit, did allow that to happen.

INTERVIEWER: Very interesting. Going back to Chicago, you talked about the core values, if that's the right word, of Chicago. What was the intellectual atmosphere like? Can you describe the kind of discussions that would be held at the Quadrangle Club?

GEORGE SHULTZ: Well, the general atmosphere was very combative. It wasn't like a bunch of people who are always saying yes to each other. People love to argue. And another attribute of the Chicago School was to always test things. That is, a theory by itself doesn't cut much ice. You have to test it. You have to get data, empirical data, gather it together, and put it against your ideas to see if the ideas hold up. And so that was another attribute of the Chicago School, always to be testing, always to be questioning. One of the reasons why it was so much fun at the University of Chicago in those days, and still is, is that general atmosphere of back and forth and argument—it was fun.

On Milton Friedman

INTERVIEWER: I'm sure that one of those who took a prominent role in these debates and wasn't afraid to fight with anybody was Milton Friedman.

GEORGE SHULTZ: Milton Friedman. Milton Friedman is a wonderful man. He and his wife, Rose, are just great people. A lot of people disagreed with Milton, some people agreed with

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him, but somehow Milton managed to set the agenda of argument. So there was a saying: Everybody loves to argue with Milton, particularly when he isn't there. He's a good arguer, and he gives a good account of himself, and he epitomizes the values in the Chicago School, but also the very serious mass of efforts to test ideas. So his *Monetary History of the United States* is a massive examination in empirical terms of what actually happened when he [tested] his ideas about the significance of monetary policy. So it isn't just ideas, it's testing the ideas and seeing if they hold up under examination.

INTERVIEWER: You said that Milton Friedman set the agenda. How do you sum up Friedman's achievement?

GEORGE SHULTZ: His achievements in professional terms were his work on monetary policy, his work on consumption, and his general impact in terms of professional ideas. But also Milton Friedman is a brilliant teacher. He has a capacity to explain something and expound on something, and he's devoted a lot of attention to that. So he and Rose together collaborated, for example, on this wonderful documentary about economics, *Free To Choose*. And his book, [*Capitalism and Freedom*] is a classic—it sold millions of copies all over the world. And the book [*Free To Choose*] that Rose and Milton authored accompanying the documentary has been widely read and widely sold on a worldwide basis. It's been translated into I don't know how many languages. So his impact was tremendous professionally, strictly professionally. But then his impact was far greater on the general population and thinking around the world because he was such a good teacher, and is such a good teacher.

INTERVIEWER: One of our interviewees described him as "the economist of the century." Is that overstating it?

GEORGE SHULTZ: Well, he certainly ranks right up there at the top, without a doubt. That's just my opinion.

INTERVIEWER: Right until about the mid-70s the kind of ideas being advanced by Milton Friedman or [Friedrich] Hayek, when he was at the university, and other people at the school were considered as sort of lunatic fringe ideas, far right, out there. Can you describe in your

own words the degree to which those ideas were not being accepted by the mainstream and why?

GEORGE SHULTZ: People in the mainstream of economics were deeply affected by the depression of the 1930s, and the writings of Keynes became sort of a central feature. People tended to emphasize fiscal policy—that is the importance of the governments' revenue and spending and the relationships of those things and the capacity. And there was necessity in their view of the government to try to manage the economy through fiscal policy. And that, I think, became a sort of central focus. And that's a focus that put monetary policy in a secondary position and doesn't pay the kind of attention that the Chicago School of people would place on markets and how the markets operate.

INTERVIEWER: How did people, enemies of the Chicago School, if you like, view people like Milton Friedman?

GEORGE SHULTZ: Well, I don't know that there were enemies. After all, economics has always had microeconomics and price theory and so on as part of it, and all economists acknowledge that. So Milton was good in a way. If you disagree with somebody, but you find yourself always losing arguments to him, you're not going to like that very much—not that he would. (laughs)

The Result of Ignoring Supply-Side Economics

INTERVIEWER: In the '70s we had the advent of this one little word, "stagflation." What was stagflation?

GEORGE SHULTZ: That described a situation where the economy was basically going nowhere and had inflation which didn't seem to get too urgent, a kind of a malaise in the economy.

INTERVIEWER: And in your view, would stagflation be a consequence of Keynesian impulses?

GEORGE SHULTZ: I think it's a consequence of not paying enough attention to the supply side of the economy; that is, to freeing people up to react to markets and to engage in their entrepreneurial activities and so on.

Nixon's Economic Policy and the Failure of Wage and Price Controls

INTERVIEWER: How did it come about that Richard Nixon adopted wage and price controls?

GEORGE SHULTZ: Well, I was there, and I opposed them. But to me it's kind of hard to explain because wage and price controls, I think you could see analytically, would get you in a lot of trouble. There was always this notion that somehow if you just had them for a little while it would get things under control and then you could go back. But it turns out it's always much easier to get into something like that than to get out of it. The immediate precipitating thing was the fact that the United States, having a set price of gold, dollar for gold, found itself in a position where people wanted to redeem their dollars for gold and you couldn't do it. And so, in the parlance of the day, we had to close the gold window. And that meant the value of the dollar would decline and that would be, in itself, an inflationary factor. And so we did have concerns about inflation, although interestingly inflation was declining and had been around 6 percent and it had gotten down below 5 percent, so it was declining. It was going well I thought. I gave a speech saying we should stay the course entitled "Steady as You Go." But at any rate, the need to close the gold window and the apparent inflationary consequence of that led the secretary of the treasury, then John Connolly, to recommend to Nixon a set of things, namely wage and price controls, to deal with the inflation and closing the gold window because we didn't want to lose the gold, and couldn't anyway sustain paying off all the debts.

And then, for good measure, Connolly added an increase in tax to protect American industry. So I was glad to see the gold window closed, but the other policies, I thought, were terrible and argued against them.

INTERVIEWER: There was a meeting in the Oval Office with you and Milton Friedman. Can you remember how the conversation went?

GEORGE SHULTZ: Milton, of course, wrote to President Nixon just as he was entering office, that the United States's posture of a fixed price of gold would not be able to be sustained and that he would be much better off just to end it immediately. He recommended that. It turned out to be right. So that part of what was done, I think, Milton thought was inevitable. It could have been done in a better way, but nevertheless was okay. But the wage and price controls and the tax were terrible, and [Friedman] said so—just as I had said so. Neither of us won.

Although after Nixon left office, I remember going down to the Nixon library and they had one of these sessions where people talked about the Nixon administration, and Henry Kissinger talked about foreign policy, and Bill Rogers talked about justice, and I was to talk about domestic policies—which I did. When I came to wage and price controls, I said, "What can I say?" Nixon laughed. He was there. (laughs) You had to look at the talent [we had around us]. Richard Nixon, John Connolly, myself, Don Rumsfeld was heavily involved, Dick Cheney was involved. A line of talented people were involved, and even with all that talent we couldn't make wage and price controls work. They're terrible. So at least maybe we proved the negative.

The Reagan Administration's Fight Against Inflation

INTERVIEWER: How did Paul Volcker set out to squeeze inflation out of the economy a few years later?

GEORGE SHULTZ: Paul Volcker was undersecretary of the treasury when I was secretary, and we worked together closely. He's a fine person, and very knowledgeable. Toward the end of the Carter administration, with inflation out of control, Paul Volcker was made chairman of the Federal Reserve. He understood the problems well, but I think it's fair to say he was under constraints as to what he could do about it.

When President Reagan took office, he had people like Milton Friedman. I was chairman of the economic policy group, Milton was a member, and there were others who said the essence of the inflation problem is monetary policy, and to deal with it effectively, you've got to discipline the money supply. Paul Volcker agreed with that, and President Reagan gave him a green light. Now people worried about that and many people warned President Reagan that if he did this, there's likely to be a recession. And obviously who wants a recession? But I can remember President Reagan using those famous words, "If not now, when? If not us, who? "

So he did the right thing and we did have recession. But also, inflation dropped like a stone. And we had basically, in the United States for the last 18 years or so, a non-inflationary environment. And that is one of the primary reasons why our economy has been as strong as it has been. So I give President Reagan and Paul Volcker a great deal of credit—and Paul's successor, Alan Greenspan, of course, has continued on and done brilliantly.

INTERVIEWER: How important was President Reagan's support for Volcker in actually seeing that policy through?

GEORGE SHULTZ: Well, to do something difficult, even if you are the independent Federal Reserve, it makes a huge difference if the president is on your side and is strong and understands the problem, and when things get tough he doesn't go the other way and denounce you, but holds in there. That was one thing about President Reagan, he understood these major developments and he wanted to be president because there were things he wanted to do as president. And so when he took actions that he thought were right, knowing that there could be difficulties, he stuck with them, he didn't run away. He had a stiff backbone.

On Ronald Reagan

INTERVIEWER: Reagan's often seen as a lightweight, isn't he, by his political enemies and people who don't know him. How much personal credit would you give him for the "Reagan revolution"?

GEORGE SHULTZ: I think he deserves most of the credit, because he took a set of ideas and he developed them, he campaigned on them, and he understood them. He understood how to translate them into operational reality and he did it. He's a political leader who can put things into effect, so you have to say, "Well, that's where the guy belongs."

Just as in Britain, where Margaret Thatcher did a lot of things, and she had help, but basically you have to say she's the one who stood up for the ideas and she's the one who put them into effect. So you had in Reagan and Thatcher at the same time, two of what I call "idea politicians." They had convictions, they had ideas, and they were convinced they were the right ideas so they put them into effect. In a way, that's why they wanted to be in office, to do that.

INTERVIEWER: To what degree was Reagan an original thinker, and to what degree was he simply getting his ideas from his own Cabinet?

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GEORGE SHULTZ: President Reagan, between the time when he was governor of California and when he became president, gave a massive number of radio talks and little talks here, there, and elsewhere. Some Hoover scholars, given access by Nancy Reagan to papers that existed in this period, discovered all these essays that he used. They were written in his own handwriting. In other words, somebody didn't write them for him. He wrote them himself. So the ideas expressed there were his ideas. And we have discovered over 600 of them. They've been published in a book entitled *Reagan in His Own Hand*. I had the privilege of writing a forward for it. And you can see for yourself by looking at these, going to agree with them or disagree with them, but they're ideas, they're full of ideas, they're his ideas and they fundamentally represent the conceptual underpinning of the Reagan presidency.

INTERVIEWER: Very good. You said that to talk about Reagan was always [difficult], that people were dismissive of Reagan during his presidency and after. I think you said that he saw the advantage in being underestimated. How did Reagan react to the putdowns that he tended to receive in the press and elsewhere?

GEORGE SHULTZ: Well, he just laughed and went about his business. And of course historians, increasingly I think, will reflect on Reagan's positive attributes and his greatness. And somehow you have to contend with the facts. When he took over as governor of California, the state had lots of problems. He ran for reelection and he was reelected overwhelmingly. When he left office after eight years as governor, the state was in great shape economically and politically. A lot of the turmoil was less, and so you have to say to yourself, "Somehow or other, he must have had something to do with that."

Then he becomes president. The Cold War is frigid. Inflation is out of control. There is malaise in the economy as described by his predecessor Jimmy Carter. The society is in a state of upset. When he leaves, the economy is strong, inflation is under control, steady. The Cold War is all over but the shouting. He transformed the situation. So somehow or other you've got to say there must be something there, and I think there is.

INTERVIEWER: Did he ever say anything to you directly about how it's kind of useful to be underestimated?

GEORGE SHULTZ: Oh, no, he didn't philosophize like that. But it didn't bother him. In fact, I think he found it useful when people underestimated his capacity, as the Washington crowd did when he came.

Reagan and Thatcher

INTERVIEWER: The Reagan revolution has had a world impact and, to a certain extent, so did what Thatcher did in Britain. Can you give an assessment of the importance of those two leaders? You've talked about what they achieved in their own countries, but in terms of their own impact abroad, Reagan and Thatcher, which is more important? Which is more prominent? Who influenced whom?

GEORGE SHULTZ: They were a good pair. They had a lot of respect for each other, they listened, and they met quite a lot. So there was a reinforcing side to it. And, of course, in the unfolding of the Cold War, and the beginnings of the work with Mr. Gorbachev even before he became the general secretary of the Communist Party in the Soviet Union, there was a lot of interaction and Margaret Thatcher met him before any of us did and before Ronald Reagan did, and her appraisal of him was a very positive one. She made a rather well publicized statement, something like "We can do business with this man." And when she thought that, then a person like Ronald Reagan said, "Well, I have to pay attention. She's not stupid. She's not wishy-washy. You know, if she thinks that, I'll pay attention." So there was a good interaction there.

On the Soviet Union and Reagan's Role in Ending the Cold War

INTERVIEWER: You touched on this in an earlier answer, but I just wouldn't mind asking you again. In 1980, Russia seemed enormously strong. It had a powerful military and had just invaded Afghanistan. The U.S. economy was in disarray, there was weak leadership, and the whole West looked like a loser. How formidable did Russia seem to Washington—to insiders like yourself—in 1979 and 1980?

GEORGE SHULTZ: Russia looked very formidable, although I had my doubts about the estimates of its economy. And also, if you looked at it carefully, you had to say that the essence of Russian or Soviet power was its ballistic missiles, nuclear tipped, which incidentally

Russia still has. So that was the essential thing. They could wipe out any country in the world in a 30-minute time [span], so that's a lot of power.

They also had a very large standing army and armed forces and were well equipped with tanks and so forth. But I always felt that the Afghan episode, for example, showed that when those forces were deployed outside the home area, they were not so good. So you always had to question, not their numbers or their equipment, but how good they would really be in battle.

I remember once, before I was secretary of state, when I went on a mission around the different heads of government for President Reagan, as I was one of his advisors and he asked me to go. My first stop was in Germany and I talked to Helmut Schmidt. Helmut complained about statements out of Washington having to do with the strength of the Soviet military machine. He said, "Yes, of course they have ballistic missiles, but when it comes to fighting on the ground, I'll put one German soldier against 10 of them." His message was that we were overestimating them. Well, I don't consider myself a military expert at all, so I listened to that. When you're in a contest like the Cold War, you have to be sure you don't underestimate your opposite number and so you need to have all the strength you can muster.

INTERVIEWER: When did you realize that the Russian economy, this great machine, was really rusted out from the inside?

GEORGE SHULTZ: Well, you could sort of sense it when you went there. And I can remember going there in the '70s when I was secretary of the treasury, and my wife would go and visit medical facilities because she was a nurse. And she'd come back and shake her head and say, "They're so far behind, the buildings are shaky."

I can remember once when I had been in a World Bank/IMF meeting in Nairobi, and my next stop was Moscow, and so the Soviets volunteered to have me spend the weekend at Sochi, their big resort on the Black Sea. And I was taken to a villa where we would spend a couple of nights, and it was built on grounds that had been there a long time, but the building itself was a relatively new structure. It was solid—it was really a solid, massive kind of building. And as we were going up the steps I looked around and I said to the person who was guiding me, whom I knew, I said, "This is a rather impressive structure." And he said, "Yes, we wanted

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you to see it so you wouldn't believe that everything good in Russia was built by the tsars." I thought it was a really telling comment. So you get exposed to a few things like that and you develop a certain skepticism.

INTERVIEWER: Reagan's often described as the man who won the Cold War. Did he? And if he did, how did he do it?

GEORGE SHULTZ: Well, he had a lot to do with it because he had strong advocacy on the level of ideas. The idea of freedom was much stronger, more powerful, and more operationally workable an idea than the idea of communism. And he said that repeatedly. He said it early on and he was greeted with skepticism. I think in an early speech in Britain, he made a statement that communism would soon be relegated, I think, to the trash heap of history or something like that. That was his view ideologically. And at the same time, he recognized the strength of the Soviet Union and the importance, if we were going to deal with them successfully, of being strong ourselves. So strength would go with diplomacy. He understood that very well.

INTERVIEWER: With hindsight, it seems as if President Reagan's commitment to heavy military spending, forcing the Russians to match it, effectively broke the back of the Russian economy. Is that fair or not? Was that a deliberate policy?

GEORGE SHULTZ: Well, I don't think it was. The policy was for us to be strong so that no one could contest our allies and us. That was the essence of the matter. And the other side had to respond. I think the key was not so much having to build up our military strength, but the most important moment was when intermediate range missiles, and particularly the Pershing missile was deployed in Germany.

Remember, during the Carter years I believe, the Soviets developed an intermediate range missile called the SS-20, and it could go from its bases in the Soviet Union and hit European targets. And the effort was to separate Europe from the United States. And NATO was determined to respond to that by deploying missiles of its own in Europe that could hit the Soviet Union.

And when Reagan took office, he developed arms control proposals. One of which was called the "zero option"; that is, that we would not deploy those intermediate range missiles if the Soviets took out of deployment its intermediate-range missiles. Again that was a proposal that was made that was derided as ridiculous and showed that he didn't believe in arms control and so on. Anyway that was his proposal.

Now there was an intense year of bargaining in 1983 and according to the schedule that NATO had set for itself, these missiles, if there were no agreement, would be deployed in November or December of 1983 in Britain, Italy and Germany. In Britain and Italy it was cruise missiles. In Germany it was ballistic missiles. The difference is that cruise missiles are controlled by the country that launches them, meaning you can do something about them after they're launched. But a ballistic missile, once you shoot it off, that's it. It's much more threatening. And of course the Soviets were allergic to anything like that deployed on German soil.

So this was a very traumatic period and they did everything they could to derail that deployment. But it went forward and it was something that we worked on in every way and I have to give a lot of credit to Helmut [Kohl] who was the chancellor in Germany for that and he was supportive. [Francois] Mitterand came to Germany, Margaret Thatcher did, and the Italians deployed on schedule. So all of this was tremendously impressive to the Soviet leadership. That NATO was cohesive and stood up to this important task.

Thatcher's Role in Ending the Cold War

INTERVIEWER: President Reagan is correctly credited in a way with "ending the Cold War." How much credit does Mrs. Thatcher get in the 1980s, helping to end the Cold War?

GEORGE SHULTZ: Winning the Cold War, bringing it to a successful conclusion was the result of a lot of effort sustained over a long period, and Ronald Reagan played an important part. But the policy of containment and the realization that there was a Cold War that had to be fought, happened in [the time of] Truman and Churchill and people of that era. The doctrine of containment evolved, NATO was created, and the Berlin airlift was one of the magnificent moments in this history. So there was a long history and I think it's not proper to say that Reagan won the Cold War, but he was very much a part of this process. And I think he was

probably the most articulate enthusiastic advocate on the idea level and in his time implemented the strategy of strength to contain, probably more effectively than ever.

INTERVIEWER: And how much credit would you give Mrs. Thatcher for that?

GEORGE SHULTZ: Well, she was right there with him on the ideological level. She led Britain to its contribution, and that contribution was strength. She deployed cruise missiles and it was a controversial issue there.

And I think there was also the impact of the Falklands, in a kind of interesting way, beyond the significance of the immediate battle. What it must have showed to the Soviets as they scratched their heads and they saw that here was a democracy that went to war to protect the freedom of people who lived 1,000 miles away on a little island. Now what does that tell you? There's some spirit there. There's something there that goes beyond just pursuing self-interest, something broader.

So I think in her successful conduct of the Falklands War she made a big point that went beyond the Falklands itself.

The Information Revolution, the Computer, and the Internet

INTERVIEWER: So moving on from all that, let's talk a little bit about the world economy. The Iron Curtain crumbled, the Berlin Wall came down, and we're now living in a kind of new world economy. What do you see as the key steps or events in the last 10 years? Can you identify those things that have actually led to this new world order economically?

GEORGE SHULTZ: What's new is a change in the availability and cost of information. And this has been something that's been building a long time. And it fundamentally stems from the computer, in my opinion.

I wrote an article and authored a book in 1961 entitled *Management Organization and the Computer*. And the idea of the book was to shake up American management and say you're using this device to compute payrolls and keep personnel records, but it's a very powerful

instrument that's going to wind up changing the way you manage your enterprises, so you'd better think more creatively about it.

When I was secretary of state, it seemed to me that the information revolution was a lot more important than people were giving it credit for, and I had the opportunity to talk to Mr. Gorbachev. I said to him once, when we were at a meeting and we had a little break, I said: "You know, we have these negotiating sessions and we argue about ballistic missiles and we argue about Afghanistan and we argue about this and that, and we argue about all manner of things. But there's something happening in the world, an information revolution that's going to affect your country, my country, everybody, and we never talk about that. It's going to change the world." And he got interested in that. And I remember saying to him, "In this new kind of world, a closed, compartmentalized system like yours is going to fall behind because in an information scene like we're going to go into, people have to communicate; they have to be free and open or you're not in the game." I think it had some impact.

But at any rate, now we have seen an explosion, I think, in the 1990s, this has come into its own. The Internet has made a huge difference. In a way you can go back to a wonderful essay that George Stigler wrote years ago, called "The Economics of Information," where he showed how important information is in an economy, how costly it sometimes is, what degrees people go to safeguard information and so on. He then asked what the impact of the internet on all of this was? It's to make information much more easily obtainable by people and much less costly to get. In the process, it eliminates a lot of people who spend their time gathering information and safeguarding information and so on. So all of this is having a profound impact on the way markets work. Markets look more like the economists' ideal of a perfect market than they used to because you get more buyers, more sellers, more information easily available to people and so the whole thing works better, and differently. So it's the new economy and I think it's very real. Whatever ups and downs the Nasdaq [stock] market may have or individual stocks may work or not work, there is an important real phenomenon that's here to stay and is going to make a huge change.

Answering Critics of Globalization

INTERVIEWER: [Why do you think a lot of people are fearful of globalization?]

GEORGE SHULTZ: I think there has been an unnecessary rise, a protest, to call attention to views about globalization that, in the end, come down to protectionism. And I say unnecessary, because I don't think people have stood up to it. In Seattle, where it started, President Clinton said he recognized the protestors had some real points and they should be included at the table. Well the fact of the matter is they didn't have much constructive to offer. What they had to offer was protectionism, and in the World Bank meetings held in Prague, the head of the World Bank, James Wolfensohn, did the same thing. He acted as though people who were protesting for something had a really important idea.

The fact of the matter is, as the world economy has been opened up, it's not only been a wonderful thing for the higher income countries, the so-called developed countries, like the Europeans and the United States and the Japanese, but it's been a wonderful thing for the less developed countries. Because they have seen that open and market-based economies work better, and in a more globalized setting they have access to all the advanced ideas that there are and they can be part of a trading system, an investment system that can help them. So it isn't as though this is negative, it's positive, and people should be getting up and saying to them, "Look, you're wrong," not "You're right; come on to the table." "You're wrong." (laughs) That's what Ronald Reagan would say. That's what Margaret Thatcher would say. We need them. (laughs)

INTERVIEWER: It seems to me that a lot of the demonstrators, or the more articulate and intellectual demonstrators, are coalescing around ideas I call anti-corporatism. In other words, they're fearful of too much power in big global multinational corporations. I mean, it's going back to the 1960s-type feeling. But do you see a threat to free markets from too much power concentrated in too few corporations?

GEORGE SHULTZ: I think what's happening is that that big corporations are having less power, not more, because what this Internet does is it empowers small groups. I have been a director of some large companies and I know the more thoughtful people in them believe our competition is not so much that big guy over there, our traditional rival, as it is some guy in a garage who has an idea we haven't thought of and who's suddenly gonna burst on the scene and really make an impact on us. That's who we have to worry about.

Reasons Behind the Asian Crisis

INTERVIEWER: Another fear that people, not only anti-WTO demonstrators, have about the new world economy is its instability, its tendency to lead to financial contagion panics.

GEORGE SHULTZ: Well, we have the Asia crisis, so-called crisis. And I think if you look at that carefully, what you'll see is that the causes were not hot money and all the things that people talk about in connection with the information age, the causes were classical mistakes. Companies had too much debt in relation to their equity. On a large scale, countries borrowed short term and they lent out long term, and the things they lent were basically illiquid assets like land values. And then they borrowed in a hard currency, dollars, and they loaned that money in a soft currency, a pegged currency that was eroding. You put these things together and you've got a formula for a problem, which is what happened. And basically you might say that the information age displayed that to people, but the mistakes were not so much having to do with the information age, as they were classical mistakes. And I think we should be careful in bailing people out as there's been a tendency to do when they make such mistakes, because they need to learn that if you make mistakes like that you'll have to be accountable for them, and so don't make them. Be careful. Do your due diligence when you make a loan.

Globalization and the Gap Between Rich and Poor

INTERVIEWER: You've touched on it slightly, but I'd like to ask you a direct question about it. I think Jeffrey Sachs is one of the people who said that 200 years ago everybody was more or less poor. We're now living in an age where in better off countries it can mean individuals can be a hundred times better off, better even than countries where they live on \$1 a week. Do you see that gap in poverty as a great moral issue for our time?

GEORGE SHULTZ: Well, you don't like to see big gaps. On the other hand, it's important to recognize that the bottom keeps coming up, and what you really need to focus on is to have a situation where people generally don't have to live in impoverished conditions. Don't have to be hungry. Don't have to be poorly housed. And I think that we see great improvements as a result of globalization in those dimensions.

"The Battle of Ideas"

INTERVIEWER: In general terms, has the move of governments out of the markets sort of affected the kind of reforms that Hayek and Friedman had been arguing for most of the century? Is that an example of the triumph of ideas?

GEORGE SHULTZ: Those ideas were there. They weren't put into practice, but more and more they weighed heavily in people's minds. The ideas were attractive to people who became political leaders, people who could do something about them. And we were fortunate that we had some leaders who had the courage of their convictions and who stuck with the ideas even when there was trouble, as when monetary discipline was exercised in the early '80s and we did have the difficulties of a recession that accompanied bringing that inflation down. President Reagan understood what was going on, and he stuck with it. And so you have the coming into being of some politicians who will use the ideas and will stick with the ideas and then all of a sudden things start changing.

The Relentless Pressure of a 24-Hour Market

INTERVIEWER: What do people dislike or fear about the modern markets, the 24-hour markets in particular?

GEORGE SHULTZ: Well, markets are bountiful, and they're very rewarding, but markets are also relentless. They operate, and if you are in a firm and your costs get too high and your prices have to stay up, nobody will buy your product and you start losing money. There's no way around it. The markets never let up, so there's a constant pressure and people like to get out from under the pressure. But in the end, organizing things that way produces, as Adam Smith told us a long time ago, a general social good.

INTERVIEWER: We talked about the new world economy. You're kind of optimistic about it, but there are people who are afraid of it. Do you see any danger of the likelihood of the pendulum swinging the other way, a return to government control?

GEORGE SHULTZ: That's always a problem, and it's always easy for people to advocate that the government should do this, that, and the other thing. It's a matter of politics, of somebody advocating the other side and being able to point to the examples and get some

assurances. So I think what has happened around the world is that there's so many examples of countries that were operated on a command and control basis, and got in trouble and then changed, and then things got better.

Take China. Take India, let alone a little country like Chile. Look at the malaise in Europe compared with the United States. Look at what's happened in the United States since we got inflation under control and we got marginal rates of taxation down. We have seen an explosion in our growth. All these examples help. But markets are relentless, they never let up.

Global Reach of the U.S. Economy

INTERVIEWER: I suppose, to an extent, the ability to strengthen the world economy depends very much on the stability of the U.S. economy.

GEORGE SHULTZ: Well, the U.S. economy is a huge proportion of the world economy, over 20 percent, and in terms of dynamism and creativity and the things that, contributes a greater percentage than that. So a healthy U.S. economy is essential to the world economy. When you have a healthy U.S. economy, even if things go a little wrong here and there, they have a tendency to come back—as long as we're an open economy.