The 'monstrous hoax' of Milton Friedman's Chicago school

by Harley Schlanger

Eagle on the Street
by David A. Vise and Steve Coll
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In a prescient volume, *The Ugly Truth About Milton Friedman,* co-authored by Lyndon LaRouche and David P. Goldman and published in 1980 in expectation of Ronald Reagan's electoral victory, the authors warned of the implications of Milton Friedman's increasing popularity and influence among American "conservatives." Friedman, who had emerged as the leading figure of the "Chicago school" (the collection of economists, social theorists, and legal "scholars" associated with the University of Chicago), was cleverly exploiting the growing disgust in the country toward "big government," especially in relationship to the failed presidency of Jimmy Carter.

In their Introduction, the authors charged that Friedman's "good repute" among conservatives "is the result of a monstrous hoax." Since Federal Reserve Chairman Paul Volcker, through applying Friedman's monetary theories (raising interest rates to "control inflation"), was wreaking havoc upon the U.S. economy, and Ronald Reagan had embraced Friedman and his associates as advisers, the authors stated that the American people were left with two alternatives: "Either we will destroy the hoax, or the hoax will destroy us."

This warning was not heeded. Ronald Reagan's presidency became a testing ground for Chicago school theories. Though deregulation, one of the rallying cries of the Chicago boys, had been initiated under Carter, it became the major domestic priority of the Reagan White House, coordinated by a blue ribbon task force headed by Vice President George Bush.

In keeping with the "free market" ideology of Friedman's shock troops who had deployed into the administration, one of the first targets was the Securities and Exchange Commission (SEC), the agency responsible for regulating Wall Street.

Eagle on the Street reviews how the SEC was crippled by the assault of the Chicago gang, and how Michael Milken, Ivan Boesky, and others profited from this assault, at the expense of U.S. industry and the U.S. taxpayer. It is the story of John Shad, who left a successful career at E.F. Hutton to come to Washington to serve as chairman of the SEC.

One of the few insiders on Wall Street to support Reagan (most had backed Bush in 1980), Shad was committed to "freeing" the markets as much as possible (i.e., giving a free hand to Wall Street). At E.F. Hutton, his specialty had been advising companies on how best to raise funds for future growth. As portrayed by Vise and Coll, this experience caused him to be obsessed with increasing the "liquidity" and "efficiency" of the markets. He had a "vision of an economy enriched by the unfettered flow of money, and of a government that regulated only when absolutely necessary."

According to Vise and Coll, Shad's attempts to convey this vision seemed as though he were describing a "religious revelation," or as Shad himself put it: "The millennium to which mankind can aspire is that great day when capital will be permitted to flow, with safeguards against fraud and with the ease of water, into every nook and cranny of economic opportunity. . . ."

Shad was fond of saying that U.S. securities markets are the "broadest, the most active and efficient, and the fairest" in the world. While he issued orders to SEC regulators to heighten vigilance against insider trading, he believed that fraud was not systemic, and a loosening of regulations in general would stimulate economic growth, rather than encourage fraud.

His beliefs coincided with the outlook of the Chicago school, and were strengthened by his appointments of Chicago school protégés to key offices. He selected University of Chicago graduate Charles Cox to serve in the newly created office of chief economist. Later, when Cox was made an SEC commissioner by Reagan, he was replaced by a rabid University of Chicago ideologue, Gregg Jarrell.

By reinforcing Shad's own beliefs, he was blinded to the dangers posed by the brave new world opened up on Wall Street by the deregulation of the Reagan years. He shared the Chicago school's admiration for Michael Milken. The authors say he viewed Milken's championing of junk bonds favorably due to his belief that it brought more liquidity to the system. When a 1981-1982 SEC investigation of Milken by the enforcement division was presented to the staff in Washington, it was dropped due to lack of "proof" of fraud.

The investigation had been triggered by SEC staff attorney Jack Hewitt's belief that he had discovered a pattern which showed that Milken and the Beverly Hills office of Drexel Burnham were engaging in tax evasion, insider trading, and numerous other violations of SEC regulations. Failure to pursue Hewitt's leads gave Milken another five years to engage in such criminal activity.

Fox guarding the chickens

Vise and Coll show that Shad punted on another critical issue of the 1980s, that of "merger mania." The raid by Bendix on Martin Marietta in 1982 was seen, by many, as a turning point for Wall Street. When the investment firms involved received astronomical fees, investment bankers were ecstatic. As they saw the takeover game, "There was no capital invested, nothing at risk, only millions of dollars in quick advisory fees." With profit margins down in retail brokerage and traditional corporate finance business, hostile takeovers were seen as an unexpected bonus. The SEC did nothing in the face of the increased volume of merger and acquisition (M&A) activity. Again, the influence of the Chicago boys was key. Chicago school followers are staunch opponents of antitrust legislation, believing that the only limits to the size of firms should be determined by the "marketplace," and that bigness, through mergers, leads to greater efficiency. (This doctrine is attributed to University of Chicago Prof. Aaron Director, Milton Friedman's brother-in-law.)

Shad responded by adopting "a new, hands-off policy" toward takeovers. When this decision provoked controversy, he appointed a blue ribbon committee on mergers in 1983. This was a classic case of the fox guarding the chicken coop. Among the members of the committee were lawyers Joseph Flom of Skadden Arps and Martin Lipton, both of whom had been in the midst of virtually every M&A battle, and whose firms charged sizeable retainers to advise companies faced with a takeover. Another member was Bruce Wasserstein, a top deal-maker, and others with a vested interest in continuing the takeover game. It was not surprising that the committee's report said there is insufficient evidence to determine whether takeovers are "beneficial or detrimental to the economy or to the securities markets in general, or to issuers or their stockholders." Therefore, the report concluded that the actions of SEC regulators "should be neither to promote nor to deter takeovers," and that takeovers "should be allowed to take place."

SEC Commissioner (and Chicagoan) Cox was more blunt in his support of takeovers. "I think there is a substantial body of evidence assembled by financial economists showing that combining firms . . . is in general economically beneficial. . . . It is not the place of regulation to determine which is a beneficial [takeover bid] and which is not," he said in 1984.

The 'leveraging of America'

As the takeover activity escalated, the size of the deals ballooned into the multibillion-dollar range. Milken's powerful junk bond machine proved that it could raise over $1 billion on a weekend. While this expansion netted huge fees for corporate raiders, as well as for the investment firms and lawyers who served as advisers, it also added billions of dollars of new debt, in the form of "leverage," to the target companies of hostile takeovers. For the protégés of Milton Friedman, the debt was of no concern. Not so for Shad, who expressed himself in a speech in June 1984, titled "The Leveraging of America." For the first time since he had taken office, he exhibited some doubts over the liberties which were being taken in the name of "free trade."

"In today's corporate world," he said, "Darwin's 'survival of the fittest' has become: 'Acquire or be acquired.' " There is no logic to this, Shad continued. "The more leveraged takeovers and buyouts today, the more bankruptcies tomorrow. . . . The leveraging-up of American enterprises will magnify the adverse consequences of the next recession."

He then struck at the core of the contention of the leveraged buyout (LBO) specialists who were terrorizing corporate America, and the Chicago school theorists, who preached that the addition of debt served to "discipline" management, forcing them to run their firms more "efficiently." "Contrary to discipline," Shad said, "the increasing threat of being taken over is an inducement to curtail or defer R&D, plant rehabilitation and expansion, oil exploration and development, and other programs which entail current costs for long-term benefits. . . . Companies that do not replace aging facilities and declining resources become increasingly inefficient."

This outraged Cox, Jarrell, and the other Chicago boys, say Vise and Coll. They conspired with their cothinkers spread throughout the bureaucracy, to rein Shad in. Among these conspirators was Douglas Ginsburg, the antitrust chief at the Justice Department, who opposed the use of antitrust laws to restrict mergers.

Victory was proclaimed by "Jarrell and the cabal," as the authors called them, when Treasury Secretary Don Regan sent a letter to the Congress in September 1984 declaring that the administration opposed adoption of any legislation to restrict takeovers. All such bills died, as the raiders, junk bond dealers and LBO junkies were given a completely free hand until the arrests of Boesky, Milken, et. al. after 1987.

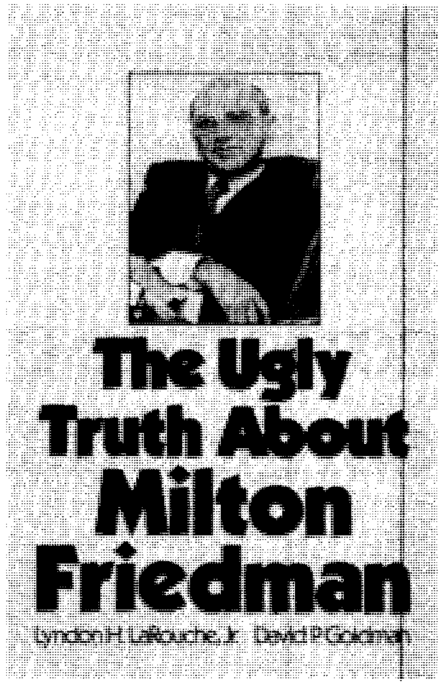
Shad's career at the SEC was deeply scarred by his capitulation on this issue and his subsequent return to the Chicago fold. As described in the last chapter of *Eagle on the Street*, "Shad had sounded warnings about the debt-driven takeovers in his 1984 'Leveraging of America' speech, but neither he nor anyone else at the commission had acted upon those words." As the robbery of the century was occurring on Wall Street, with Milken, LBO scam artists like Kohlberg, Kravis and Roberts, investment bankers, and law firms like Skadden Arps, skimming more than $60 billion from takeover deals while placing companies under crushing debt and systematically dismantling U.S. industry, Shad ended his days at the SEC preaching the gospel of the Chicago school.

The successful prosecutions of a mere handful of these crooks—most notably Milken—which is detailed in the second half of the book, only temporarily slowed the destructive forces unleashed in the 1980s, and is small consolation to the millions of Americans whose pension funds, insurance companies, and savings and loan institutions have been picked clean by these bandits.

The ugly truth about the Chicago school

Though Vise and Coll give the reader some idea of the network of University of Chicago operatives and their influence within the Reagan administration, they fail to identify the evil that Friedman's cothinkers truly represent. For this, the reader must go back to LaRouche and Goldman's *The Ugly Truth About Milton Friedman.*

The "monstrous hoax" which Friedman has pulled off against conservatives is that he and the University of Chicago stand directly opposed to the American System of economics, the foundation upon which the United States was built. They are neither patriotic, nor are they "conservative"; in fact, they are the embodiment of the philosophical radicalism, sometimes known as British liberalism, that the Founding Fathers of the United States rebelled against.



The warnings of Lyndon LaRouche and his associates in 1980 about the "Chicago school" of Milton Friedman went unheeded, and now, David Vise and Steve Coll are left to write the post-mortem of the havoc the Chicago school wreaked at the Securities and Exchange Commission under John Shad.

The University of Chicago was founded in 1892, as an outgrowth of the "settlement house" movement. This movement was transplanted to the U.S. by the British Fabian Society, the forerunner to the Labour Party, which conceived of these centers as a kind of "social engineering project." The University of Chicago was established as a think tank, to develop "ideas and theories" for the most famous of the U.S. settlement houses, Jane Addams's Hull House.

Funding was provided by the "Our Crowd" financial networks of New York (and delivered by future U.S. Supreme Court Justice Louis Brandeis), John D. Rockefeller, and Marshall Field, whose heirs have been the financial angels for the "technological apartheid" gang since the 1960s. In their book, LaRouche and Goldman identify how the University of Chicago served the interests of the anti-American British radicals from the outset. The University of Chicago, they say, was built "as a center of British intellectual subversion against the fundamental tenet of the American System—the necessity of technological progress." From the beginning, the Economics Department was staffed to accomplish that task. Its first chairman, J. Laurence Laughlin, was the leading spokesman for the Cobden Clubs, which were attacking the adoption of a tariff policy to protect U.S. industry from the British "free trade" policies. Throughout U.S. history, the battle of American System versus British system economics focused on this question, with the British always attempting to impose Adam Smith's "free trade" policies, by gunboats if necessary.

One of Milton Friedman's teachers at the University of Chicago was Wesley Clair Mitchell, a notorious proponent of the British system. In Mitchell's doctoral dissertation, "The History of Greenbacks," he attacked President Lincoln's economic policy and supported instead the British-dictated Specie Resumption Act of 1879. It was Mitchell who dedicated his life to bringing about the union, at the University of Chicago, of British economics with the degenerate Austrian school.

The result of this union was Milton Friedman!

Those American conservatives who have been chanting the mantras of Friedman and the Chicago school—as did Reagan, Shad, and others who presided over the catastrophic 1980s—might be shocked by Friedman's self-description, from his 1962 book *Capitalism and Freedom*. In it, he defines his political and economic outlook by saying the "rightful and proper label is liberalism. . . . 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 19th-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 must be his modern heir*" (emphasis added).

This anti-industrial radicalism is what was unleashed by the Chicago school fanatics during the 1980s. Despite the prosecution of Milken and several others, the Chicago boys are pleased. The collapse of the U.S. economy into a post-industrial rubbish heap was furthered by their presence in the Reagan administration, and it is accelerating today under Bush.

Vise and Coll only brushed the surface with their book. On this matter, as on so many others, it is LaRouche who has been proven right.