Milton Friedman - A Brief Obituary

by

David Laidler

Research Report # 2007-1 **January 2007**

Department of Economics
Research Report Series

Department of Economics
Social Science Centre
The University of Western Ontario
London, Ontario, N6A 5C2
Canada

Milton Friedman - a Brief Obituary*

by

David Laidler
Professor Emeritus at the University of Western Ontario
Fellow in Residence at the C.D. Howe Institute

This obituary has been prepared for the *European Journal of the History of Economic Thought*
I am grateful to Jose Luis Cardoso, Robert Hetzel, Robert Leeson and Antoin Murphy for helpful comments on an earlier draft.

Abstract : Milton Friedman is rivaled only by John Maynard Keynes as the most influential political economists of the 20^{th} Century. His approach was that of a classical liberal, rather than a conservative, though this put him on the political right in the United States. Friedman's work demands to be evaluated all of a piece, but his outstandingly important technical contributions to economics influenced the development of the discipline in ways that extended far beyond the purview of any particular political agenda.

I

Milton Friedman was one of the most influential political economists of the twentieth century, and was much honoured for his work as well, receiving the AEA's John Bates Clark Medal in 1951, a Nobel Prize in 1976, not to mention the United States' Presidential Medal of Freedom and National Medal for Science in 1988.

To begin with his impact on the discipline of economics: the program of a recent conference marking the fiftieth anniversary of his (1953) essay on "The Methodology of Positive Economics" (Erasmus Institute for Philosophy and Economics, 2003), termed it "the most important piece of methodological writing in 20th century economics"; his 1940 Ph.D. thesis, eventually published as *Income from Independent Professional Practice* (Friedman and Simon Kuznets1945), is one of the founding works of modern labour economics; it is also the source of the permanent-transitory distinction that lay at the heart of *A Theory of the Consumption Function* (1957) , a book which in its turn did much to change the direction of macroeconomic theory; and then, of course, there were his crucial contributions as a monetary theorist, applied econometrician, and narrative economic historian to what Harry Johnson (1971) called the "Monetarist Counter-revolution" in macroeconomics.

In the public arena Friedman's influence derived from his tireless efforts, as author, journalist, lecturer, broadcaster and adviser to politicians to popularize and see implemented a political economy whose core beliefs are readily apparent from the titles of his two best selling books, *Capitalism and Freedom* (1962) and *Free to Choose* (1980), the former written with the assistance of, and the second co-authored by, his wife Rose Director Friedman.

II

Friedman was born in Brooklyn in 1912, to Jewish immigrants from an eastern province of the Habsburg Empire that is now part of the Ukraine. He was brought up in Rahway, New Jersey, educated in the public school system and he graduated from Rutgers University in 1932. He went on to Chicago and then Columbia for graduate work, and in 1935 found his first employment in New Deal Washington while still working on his Ph. D. Applying the usual stereotype to such beginnings, one might have expected Friedman's political economy to lean to the left, and the Presidents and presidential candidates he would later advise to have names like Kennedy, Johnson and Humphrey. Though the Friedman we now remember was no conservative - among his causes, as Robert Hetzel (2007) notes, were the abolition of the military draft (successful), the legalization of drugs and prostitution (unsuccessful) and the promotion of education vouchers (partially successful) - he was nevertheless a liberal in the traditional European, not the modern American, sense; and that is why he made his political home on the right, where the principal recipients of his advice were Barry Goldwater, Richard Nixon and Ronald Reagan.

Even so, Friedman did live up to the stereotype for a while. When he married in 1938, his brother-in-law-to-be, Aaron Director promised his sister “not to hold his very strong New Deal leanings - authoritarian to use an abusive term - against him” (Friedman and Friedman 1998, p. 81, fn.); his first writings on inflation (eg.1943) were indirectly inspired by Keynes (1940) and skeptical about the quantity theory’s usefulness, while his earliest work on macro-stabilization policy (1948) paid at least as much attention to fiscal as to monetary measures. The slow evolution of Friedman’s views on political economy must in part have been under the influence of his wife and brother-in-law, who underwent a similar shift of allegiance early in the 1930s when they drifted away from their original Chicago mentor, the at-that-time socialist under-consumptionist Paul Douglas, into the circle of Frank H. Knight. But there is nothing in the record to contradict his own suggestion that his serious concern with public policy and political philosophy began in the early post-war years at Chicago, where “informal discussions with colleagues and friends stimulated a greater interest, which was reinforced by Friedrich Hayek’s powerful book *The Road to Serfdom*, by my attendance at the first meeting of the Mont Pelerin society in 1947, and by discussions with Hayek after he joined the university faculty in 1950. . .” (Friedman and Friedman, 1998, p. 333)

Whatever the influences, however, and Friedman was always more interested in the current relevance of ideas than in their historical origins, by 1962 he was arguing, in *Capitalism and Freedom*, that capitalism founded on voluntary exchange among well informed agents was a necessary condition for political freedom, and that, if not also sufficient, it nevertheless provided a firm foundation for the maintenance of such freedom where it already existed, and a powerful impetus to its development where it did not. Published at a time when John Kenneth Galbraith’s *Affluent Society* (1958) still defined the state of the art for popular economic writing in the US, when Europe’s welfare states appeared at last to be delivering prosperity after a long period of post-war reconstruction, and just as John F. Kennedy was launching his Great Society, this book seemed extremist, and was at first more often ignored than criticized by the guardians of informed opinion. *The Economist*, to its credit was an exception, commending it in anonymous (1963) review as “A Tract for the Times”, and noting its advocacy of, among other things, the use of a money-supply rule to generate built-in macroeconomic stability, flexible exchange rates, and a negative income tax.

Capitalism and Freedom’s most salient characteristic was its relentless application of the idea that bilateral voluntary exchange creates gains for both parties, and that the more widespread its use, the more widespread also are these gains likely to be. Those who, like this author, had the privilege of learning their price theory from Friedman in person in the early ‘60s soon noticed, as Robert Hetzel (2007) has also recently recorded, that what distinguished him was not his views on what everyday micro-economics said, but on how seriously its implications should be taken; and *Capitalism and Freedom* conveyed exactly this enthusiasm about competitive theory’s real-world relevance. This is what ultimately made it a classic, and helped to persuade many a skeptical reader to think hard about its political message. Friedman did not put classical economic liberalism back on political economy's map single-handedly of course, but *Capitalism and Freedom* was a major landmark on a road along which its author was thereafter to guide many. When *Free to Choose* appeared in1980, it was still a radical book, but its reception was a great deal more respectful, even among the many who still did not quite accept its whole message.

III

Friedman's contribution to 20th century economic thought should be seen as all of a piece, because its popular and political components drew heavily on his scholarly and scientific output, but the latter nevertheless exerted an influence on the internal dynamics of economics that was largely independent of the uses to which he himself put it within his own political economy.

For example, though much of *Capitalism and Freedom* - and later of *Free to Choose* as well - was based on the premise that the economic analysis of maximizing behaviour in competitive markets was of immediate and compelling empirical relevance, and though Friedman had earlier argued this view at considerable length in his (1953) essay on "The Methodology of Positive Economics", this proposition was neither that essay's central message nor the source of its subsequent academic influence. Rather, it was a by-product of Friedman's use of contemporary debates about the merits of models of maximizing behaviour to illustrate the virtues of his recommended approach to any such debate. This was to judge economic theories, not by the "realism" of their assumptions, but by the extent to which their predictions are or are not supported by empirical evidence.

To be sure, Friedman had specific views about the relative merits of profit maximization and mark-up pricing as explanations of firms' behaviour, and about the empirical relevance of the competitive model more generally; but it was neither necessary to share these in order to find his methodological prescriptions intriguing and challenging, not to say full of hidden difficulties when they were carefully examined in the light of competing approaches to the philosophy of science, nor even to take to heart their "softer" message, as expounded by Thomas Mayer (1992), that actually deploying economic theories as a basis for empirical research was likely to be a more useful activity than arguing in the abstract about whether they could or should be employed in this way in the first place.

Thus, though this 1953 essay was vital to the development of Friedman's political economy, its subsequent status as a seminal work in the methodology of economics was quite independent of this. So too was its role in helping to persuade economists to pay more attention to empirical work, though here one must not overlook the influence of Karl Popper - not quite co-incidentally also a participant in that first 1947 meeting of the Mont Pelerin Society - on the LSE's seminar in Methodology, Measurement and Testing and on Richard Lipsey's magnificent textbook, *An Introduction to Positive Economics* (1963). Nor should one forget how much easier systematic econometric work became as electric-mechanical calculators were replaced by electronic computers in the 1960s.

Friedman's contributions to macroeconomics in general, and monetarism in particular, had a similar dual significance for the development of both the discipline and his own political economy, as I have argued at greater length in David Laidler (2005). *A Theory of the Consumption Function* located the consumption-saving decision in an explicitly stochastic environment, and then forged a link between the maximizing principles that had usually been deployed quite separately in economic and econometric theory to analyze that decision's fundamentally forward looking nature. In this respect the work was seminal for the subsequent evolution of macroeconomics. So too, albeit on a less fundamental level, were the studies that emerged from Friedman's Chicago Money Workshop from the early 1950s onwards (See e.g. Friedman (ed.) 1956 and David Meiselman (ed.) 1970). Many of these relied on the idea of an empirically stable demand for money function to analyze episodes of high and hyper-inflation in far off times and places, but some of this work also suggested that the same relationship might fruitfully be formulated as a special application of the permanent income hypothesis and applied to 20th century United States data. All of this, along with Friedman's (1968) analysis of the influence of expectations about inflation on the behaviour of forward looking agents, and hence on the nature of the inflation-unemployment trade-off – from a purely technical standpoint identical to the contemporary work of Edmund Phelps (1967) - provoked vigorous debates that kept applied macroeconomic research extremely lively well into the 1970s.

But that is not the whole story, for many of the policy implications yielded by this work also ran counter to the activist ideas that, as Hetzel (2007) has stressed, dominated economics well into the 1960s. His consumption function maintained the idea of a stable marginal propensity to *consume*, but applied it to permanent, rather than current income, thus rendering the marginal propensity to *save* out of the latter unstable; and it was this parameter whose empirical stability was required for the Keynesian multiplier concept to be used easily in the design of fiscal measures. Even as it downgraded the reliability of fiscal policy, moreover, Friedman's work simultaneously made a case for the importance of monetary policy, or rather monetary policy of a particular sort. A stable demand for money function seemed to imply both that fixing the growth rate of the money supply by rule was the key to maintaining economic stability (Friedman 1960), and that rapid and unstable money growth would cause unstable inflation, even in the contemporary United States.

These conclusions were in strong opposition to policy doctrines which emphasized discretionary stabilization policy, downplayed the significance of money, and interpreted inflationary pressures in modern economies as "cost-push" phenomena that perhaps required wage-price guidelines or even controls to contain them. Even so, not all of them followed immediately and necessarily from Friedman's theoretical premises. In his hands, for example, the expectations augmented Phillips curve was a component of his case that the pursuit of employment goals was not a proper role for monetary policy, whereas the implications that Phelps drew from the same analysis was simply that the inflation-unemployment trade-off was dynamic rather than static, and that policy aimed at achieving optimal unemployment had to take account of this.

But perhaps, in the long run, the most significant contribution of Friedman's work on monetary questions was to undermine the central empirical preconception upon which the intellectual legitimacy of any kind of interventionist macro-policy rested: namely, that the experience of the Great Depression had demonstrated the inherent instability of the market economy. The chapters of *A Monetary History of the United States* (Friedman and Anna J. Schwartz 1963) that dealt with this episode made a detailed and compelling case that the Depression had in fact been the result, not of some fault in the market economy, but of monetary policies too inept and destabilizing for that economy to withstand. Though the economics profession took Friedman and Schwartz's claims seriously from the start as an interpretation of a particular historical episode, debating and modifying them as it absorbed them, it took it longer to grasp that those claims also effectively destroyed the empirical support for by-the-1960s conventional views about the flawed nature of capitalism, and the need for continuously activist macroeconomic policy to ensure its survival.

IV

Keynes' *General Theory* (1936) was published as the period whose economic ills it diagnosed was coming to its end. In remarkable contrast, Friedman's doctrines were essentially complete *before* the onset of the great inflation that seemed both to confirm their validity and invite of them a cure, and it was not until the 1970s and '80s that they made their move from the realm of academic ideas into that of practical policy. This transition inflicted considerable damage on their reputation.

Not least, this was because their first trial run was in Chile, under the auspices of Augusto Pinochet, who in 1973 had, with support from the Nixon administration, overthrown an economically incompetent but nevertheless democratically elected socialist government, and set aside the constitution under which it had come to power The resulting association of economic liberalism with murderous military dictatorship lent an awkward degree of credibility to the view, in wide circulation well before 1973, particularly in Europe and far beyond the confines of the hard left, that Friedman's political economy, whatever might be claimed for it in principle, was in practice incompatible with democracy.

Though Friedman's personal involvement in Chile was minor - a six day visit in early 1975, under ostensibly private auspices, one forty-five minute meeting with Pinochet himself, followed up by a single letter - it generated protests and personal harassment that would dog him for years thereafter. The political and ethical issues raised by this affair are too complex for discussion here, but no historian of late twentieth century economic thought should ignore it, because, fairly or not, it left stains on the reputations of classical economic liberalism, and of Friedman himself, that proved extremely hard to remove, witness the fact that as late as 1998, Friedman himself found it necessary to devote a whole chapter and an appendix in *Two Lucky People* to an account of the episode and a defense of his role in it.

Nor did all of Friedman's more narrowly technical ideas work out well in the 1970s and '80s. In particular, as Laidler (2005) discusses in greater detail, the money supply growth rule, which he had been recommending as a means of maintaining macroeconomic stability for two decades, turned out to be much harder to adapt to the task of restoring stability to the turbulent and inflation prone economies of the times than many had expected, not least because the capacity of institutional change within the financial system to undermine the stability of the demand-for-money functions on which it relied had been grossly underestimated.

V

Important though these criticisms are, however, Friedman's reputation will surely survive them with ease. To begin with, his important long-term influence on the evolution of economics has already been noted above, and no amount of political controversy can change it. It is arguable too that the practical policy successes of his ideas comfortably outweigh their failures.

This is nowhere more evident than in the monetary field. Though, with the important exception of the ECB, it is nowadays hard to find a central bank that pays much attention to money growth, it is nevertheless taken for granted among those institutions that inflation is a monetary phenomenon, and therefore their responsibility. And it is almost as widely accepted that inflation cannot be controlled at the national level without exchange rate flexibility. In these respects, the phrase "monetarism without money" is an excellent first approximation to describing what has now become an essentially word-wide orthodoxy. Nor do we nowadays hear nearly as much about the virtues of economic planning or the need for activist fiscal policies to maintain economic stability as we did in the 1950s and '60s. Significantly also, the fact that a number of eastern European countries have demonstrated the possibility of moving from incompetent - and even authoritarian - socialism towards economic and political liberalism without military assistance is beginning to repair some of the damage done to that doctrine's reputation by the Chilean episode.

Even so, the contemporary world remains far from approximating Friedman's uncompromising version of the classical liberal ideal. Notably, the welfare state remains alive and functioning, particularly in Europe. That is because, to use the *Economist*'s 1963 words, many still find "his notion that people who are neither children nor insane are responsible" too simple to make it the basis for the whole of economic and social policy, and because many of those ". . . who agree with him that one cannot be both a liberal and an egalitarian . . . [still] feel that prisons, asylums and cash are insufficient to look after the poor and weak".

But taken overall, economic policy everywhere has moved significantly in Friedman's preferred direction since the early 1960s, partly in response to events no doubt, but also under his influence. If his role in the development of his own discipline alone was enough to make him an economist of the first order of importance, therefore, this broader impact surely confirms Friedman's status as one of the twentieth century's greatest political economists. Perhaps only Keynes stands as a serious rival.

References

Anonymous (1963) "A Tract for the Times: *Capitalism and Freedom* By Milton Friedman" *The Economist* February 16th

Erasmus Institute for Philosophy and Economics (2003) "Theme, Programme and Papers for a Conference on The Methodology of Positive Economics: Milton Friedman's Essay at 50", Rotterdam (http://www2.eur.nl/fw/philecon/Friedman53.html)

Friedman, Milton (1943) "Methods of Forecasting Inflation" in Shoup, Carl, Milton Friedman and Ruth Mack, *Taxing to Prevent Inflation: Techniques for Estimating Revenue Requirements,* New York, Columbia University Press

-------------------- (1948) "A Monetary and Fiscal Framework for Economic Stability" *American Economic Review,* reprinted in *Essays in Positive Economics* (1953)

--------------------- (1953) "The Methodology of Positive Economics" in *Essays in Positive Economics,* Chicago, University of Chicago Press

--------------------- (1957) *A Theory of the Consumption Function,* Princeton NJ, Princeton University Press for the NBER

---------------------- (1960) *A Program for Monetary Stability,* New York, Fordham University Press

--------------------- (1962) *Capitalism and Freedom,* Chicago, University of Chicago Press

--------------------- (1968) "The Role of Monetary Policy" *American Economic Review* 58 (March) 1-18

--------------------- (ed.) (1956) *Studies in the Quantity Theory of Money,* Chicago, University of Chicago Press

--------------------- and Rose Director Friedman (1980) *Free to Choose* New York, Harcourt Brace Jovanovich

--- (1998) *Two Lucky People,* Chicago, University of Chicago Press

---------------------- and Simon Kuznets (1945) *Income from Independent Professional Practice,* New York, NBER

---------------------- and Anna Jacobson Schwartz (1963) *A Monetary History of the United States 1867-1960,* Princeton NJ., Princeton University Press for the NBER

Galbraith, John Kenneth (1958) *The Affluent Society* Boston, Houghton Mifflin

Hetzel, Robert L.(2007, forthcoming) "The Contributions of Milton Friedman to Economics" Federal Reserve Bank of Richmond *Economic Quarterly* 93 (winter)

Johnson, Harry G. (1971) "The Keynesian revolution and the Monetarist Counter-revolution" *American Economic Review* 61 (May, papers and proceedings) 9-22

Keynes, John Maynard (1936) *The General theory of Employment, Interest and Money,* London, Macmillan

-------------------------- (1940) *How to Pay for the War,* London, Macmillan

Laidler, David (2005) "Milton Friedman and the Evolution of Macroeconomics" *EPRI Working Paper* 2005-11, Dept. of Economics, University of Western Ontario

Lipsey, Richard G (1963) *An Introduction to Positive Economics,* London, Weidenfeld and Nicholson

Mayer, Thomas (1993) "Friedman's Methodology of Positive Economics: a Soft Reading" *Economic Inquiry* 31 (April) 213-223

Meiselman, David (ed.) (1970) *The Varieties of Monetary Experience,* Chicago, University of Chicago Press

Phelps, Edmund S. (1967) "Phillips Curves, Expectations of Inflation and Optimal Unemployment over Time" *Economica* NS 34 (August) 254-281