

Milton Friedman

“Behind Every Politician is
A Dead Economist”

(source: I don't know, but wish I'd said it.)

Milton and Rose Friedman



A Short Biography

- Milton Friedman (1912--2006) was born in Brooklyn, New York
- Friedman met his wife, Rose Director (1910(1)--2009), while a graduate student at the University of Chicago
 - They were married in 1938
 - They had two children

A Short Biography

- Friedman's Education:

- B.A. (1932) Rutgers University
- M.A. (1933) University of Chicago
- Ph.D. (1946) Columbia University

- Faculty at the University of Chicago from 1946 to 1976.

- He also held positions at various other institutions (NBER, University of Wisconsin, University of Minnesota, Cambridge, Columbia, Stanford, etc...)

Prestigious Awards

- Friedman was awarded The Sveriges Riksbank Prize in Economic Sciences in Memory of Alfred Nobel in 1976
 - “for his achievements in the fields of consumption analysis, monetary history and theory, and for his demonstration of the complexity of stabilization policy.”
- Friedman was awarded
 - The John Bates Clark Award (1951)
 - The National Medal of Science (1988)
 - The Presidential Medal of Freedom (1988)

Friedman's Intellectual Legacy

- Friedman is mainly associated with two schools of thought:

1. The Chicago School of Economics

2. Monetarism

- While your minds are still fresh, we will start with

Monetarism

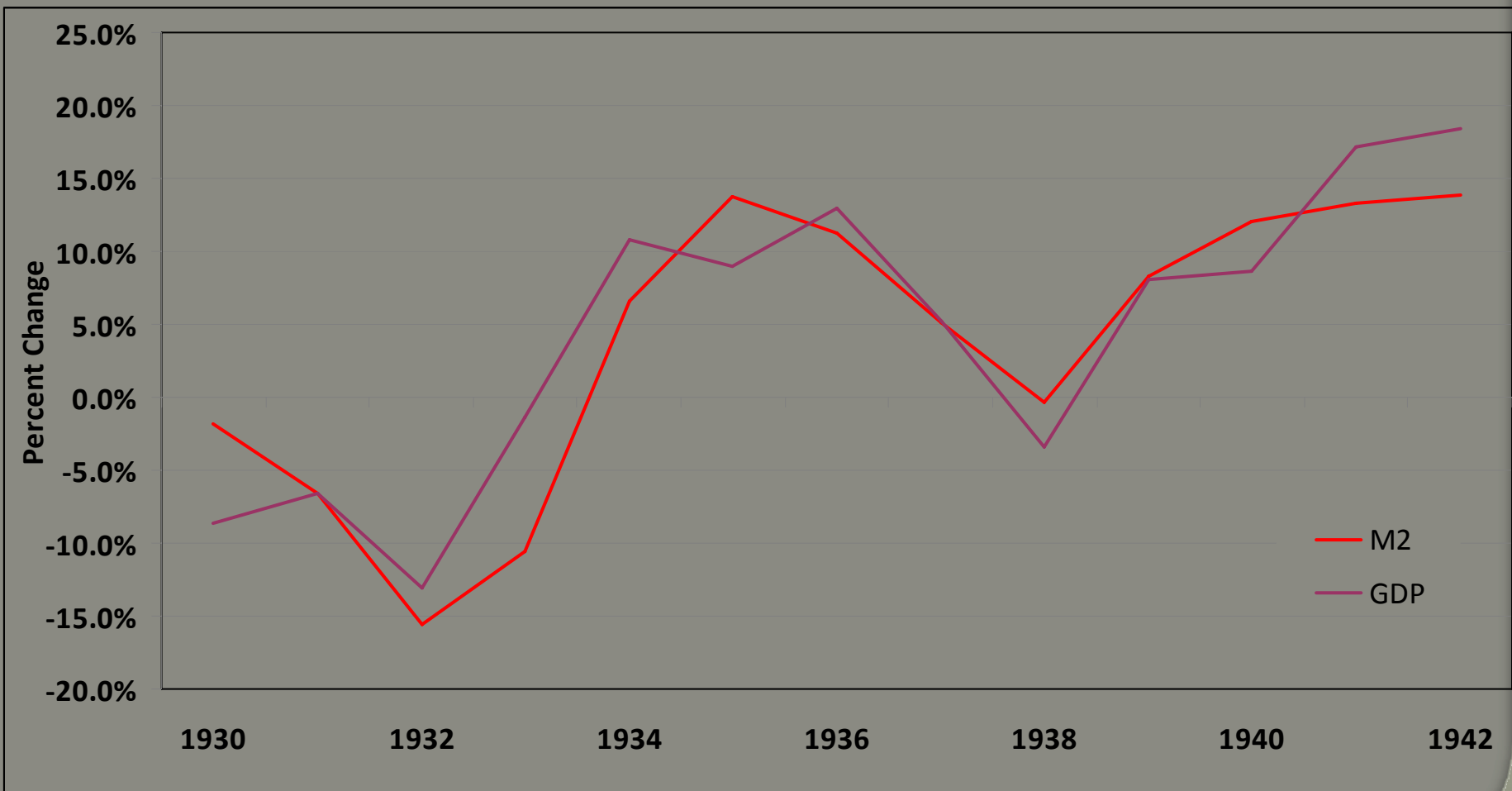
Monetarism

- Friedman's ideas about monetary policy and inflation have altered the conduct of monetary policy.
- The Federal Reserve Bank ("The Fed") is in charge of the nation's monetary policy
- Not surprisingly, Friedman was a critic of The Fed.

The Great Contraction

- Friedman's most ambitious work is:
 - *A Monetary History of the United States, 1867-1960 with Anna Schwartz. Princeton University Press, 1963.*
 - Friedman and Schwartz argued that the Great Depression was prolonged and perhaps caused by the Federal Reserve Bank.
 - The FED did not supply enough money, and the monetary contraction helped turned the recession into the Great Depression.

Friedman and Anna Schwartz Argued that the Great Depression Was Caused by The Fed's Permitting Money Supply to Shrink -- Calling It "The Great Contraction"!



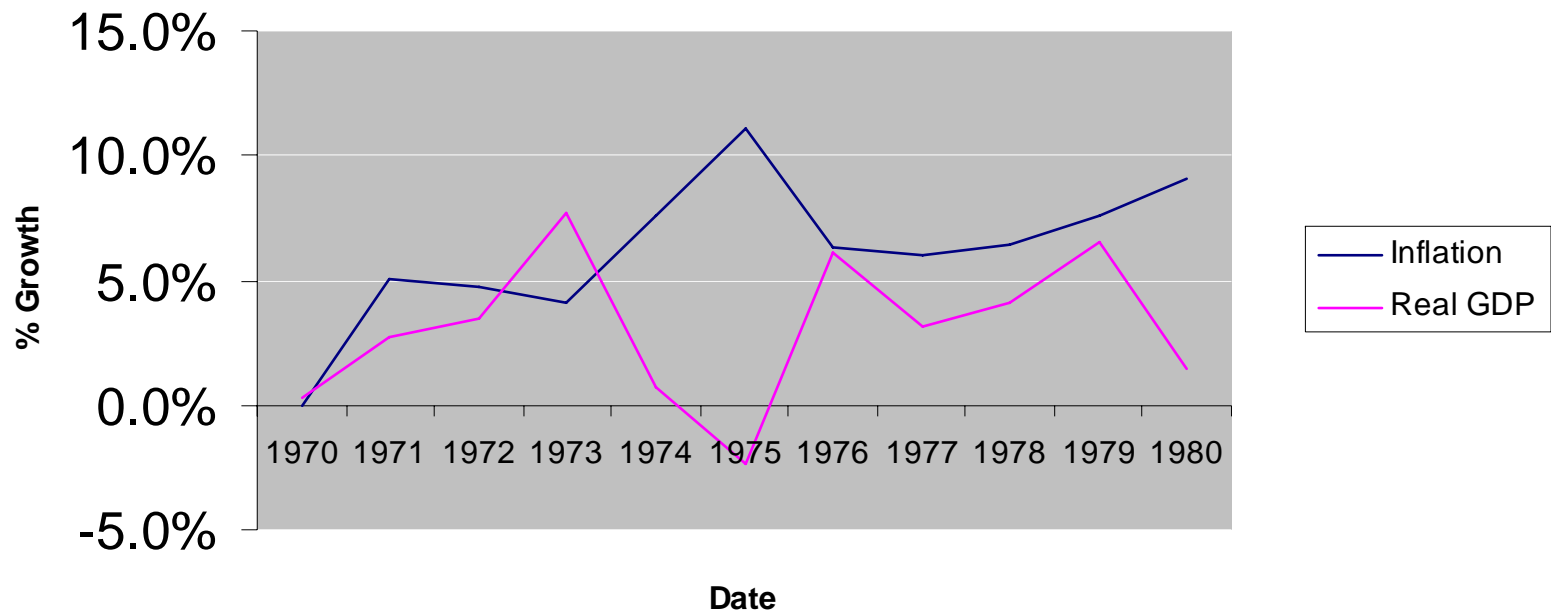
Monetarism

● Friedman on Inflation:

- *“Inflation is always and everywhere a monetary phenomenon in the sense that it is and can be produced only by a more rapid increase in the quantity of money than in output”*
 - *The Counter-Revolution in Monetary Theory (1970)*
- The tradeoff between unemployment and inflation (the Phillips Curve) is not stable. It is possible to have both high inflation and high unemployment (Stagflation).
- Friedman’s warnings were confirmed during the 1970s stagflation, wrought by Jimmy Carter’s Fed Chairman!!!!

The Carter Fed's Stagflation

Stagflation in the 70's



How *Should* The Fed Operate?

Friedman's Rule

- Friedman's Proposal -- Fed Should Make:

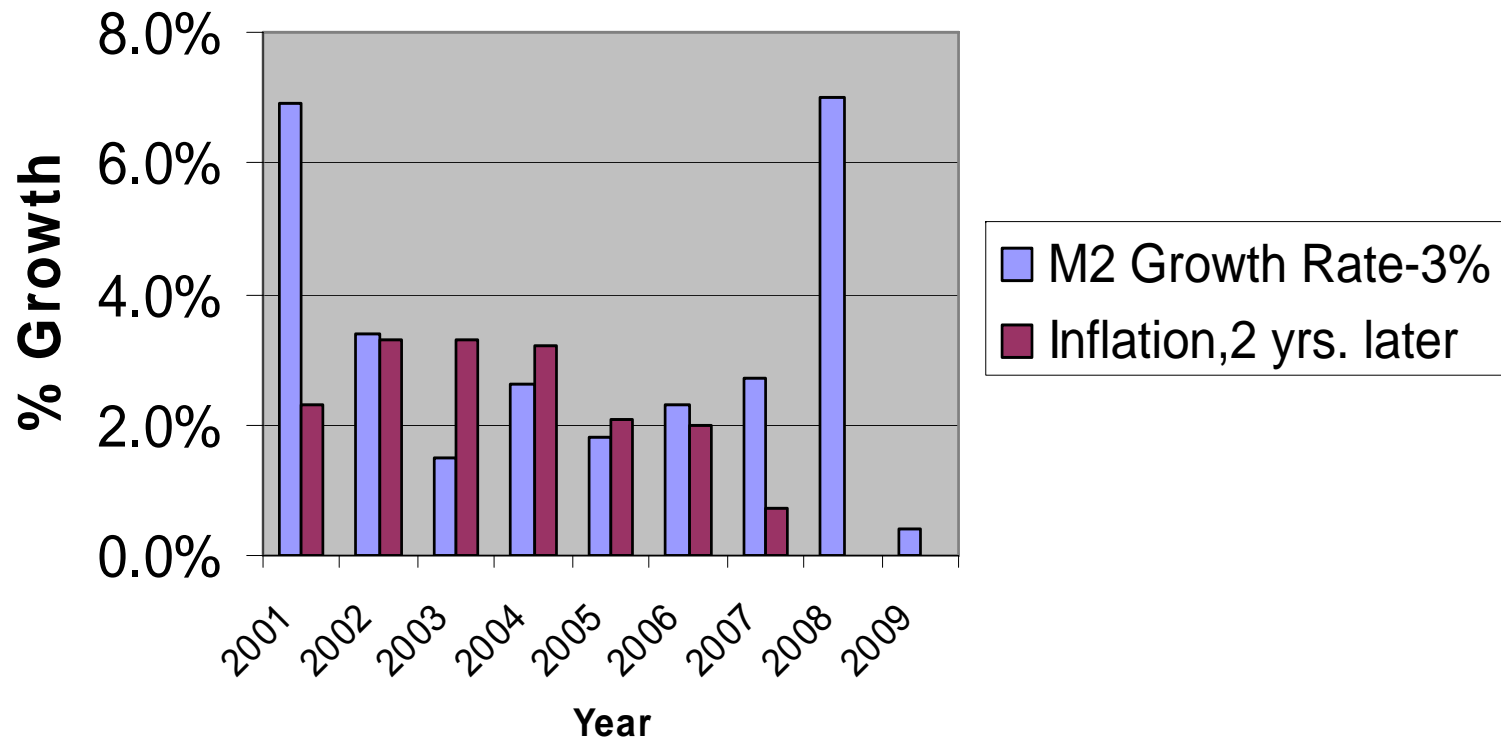
$$\text{M2 Growth Rate} = \text{Inflation Rate Target} + 3 \%$$

where M2 = currency + checking and savings deposits

- Friedman Thought the Rule Worked With a 2 yr. Lag
- How has this worked recently?

Friedman Rule vs. Actual Fed Policy: The Fed Acted Like Its Inflation Target = 2-3%

Friedman Rule Inflation Prediction



What Would Friedman Say Today?

- In October 2008, for the first time in history, the Fed started paying interest on bank reserves, comparable to rates paid on Fed Funds and T-Bills. This encourages banks to hold reserves in excess of requirements.
- As loan prospects improve, the Fed will either have to drain reserves (by sales of the loans and securities on its books) or further increase interest paid on reserves, to limit rapid growth of lending and consequent creation of deposits and high money supply growth rates.

The Chicago School of Economic Thought

“It describes a neoclassical school of thought within the academic community of economists, with a strong focus around the faculty of University of Chicago.”

- The main players were Frank Knight, Friedrich von Hayek, Ronald Coase, George Stigler, Milton Friedman, Robert Fogel, Gary Becker, Richard Posner, Robert Lucas, and Eugene Fama.
- This Spread To Economics Depts. Everywhere

Chicago School: Basic Tenets

- Markets are a good way to organize voluntary and beneficial exchanges
- Government serves more as “umpire” than as socialist organizer of economy
- Economic power serves as a check and a counter to political power (e.g. USA contrasted with Chavez’ Venezuela).

Prescient Quote for Venezuela:

It is a mark of the political freedom in a capitalist society that people can openly advocate and work for socialism.

How could the freedom to advocate capitalism be preserved and protected in a socialist society?

Source: Friedman, Capitalism and Freedom, 1962

Markets and Minorities Rights

The preservation of Jews through the Middle Ages was possible because of the existence of a market sector in which they could operate and maintain themselves despite persecution.

Yet paradoxically enough, the enemies of the free market – the Socialists and Communists – have been recruited in disproportionate measure from minority groups.

Source: Friedman, Capitalism and Freedom, 1962

Chicago School: Advice

- On Government “Stimulus” Packages:

...plan tax rates so as to provide sufficient revenues to cover planned expenditures on the average of one year with another, again without regard to year-to-year changes in economic stability.

- Hence, he would have opposed the recent Federal “Stimulus Packages”

Source: Friedman, Capitalism and Freedom, 1962

Chicago School: Advice

● On Education Funding

Governments should require a minimum level of schooling financed by giving parents vouchers redeemable for a specified maximum sum per child per year if spent on “approved” educational services....like the GI Bill.

Source: Friedman, Capitalism and Freedom, 1962

Chicago School: Advice

- Monopolies Are Bad, Even Governmental

The historical reason why we have a Post Office monopoly is because the Pony Express did such a good job of carrying mail across the continent that, when the government introduced transcontinental service, it couldn't compete effectively and lost money.

Source: Friedman, Capitalism and Freedom, 1962

- This is happening again today!!

Chicago School: Advice

● On Social Security

What conceivable justification is there for taxing the young to subsidize the old regardless of the economic status of the old....It is doubtful that the taxes paid have sufficed to finance the accumulated obligation.

Source: Friedman, Capitalism and Freedom, 1962

Chicago School: Advice

● On Government Anti-Poverty Policy

The program, that is, should be designed to help people as people, not as members of particular occupational groups or age groups or wage-rate groups or labor organizations or industries...

The arrangement that recommends itself on purely mechanical grounds is a negative income tax.

Source: Friedman, Capitalism and Freedom, 1962

- Eventually, this was implemented as the “Earned Income Tax Credit”

A Parting Thought

There is still a tendency to regard any existing government intervention as desirable, to attribute all evils to the market, and to evaluate proposals for government control in their ideal form, as they might work if run by able, disinterested men, free from the pressure of special interest groups. The proponents of limited government and free enterprise are still on the defensive.

Source: Friedman, Capitalism and Freedom, 1962