BY JULIAN KIKUCHI

Milton Friedman, Dissenter

The architect of modern monetarism was also an energetic public intellectual

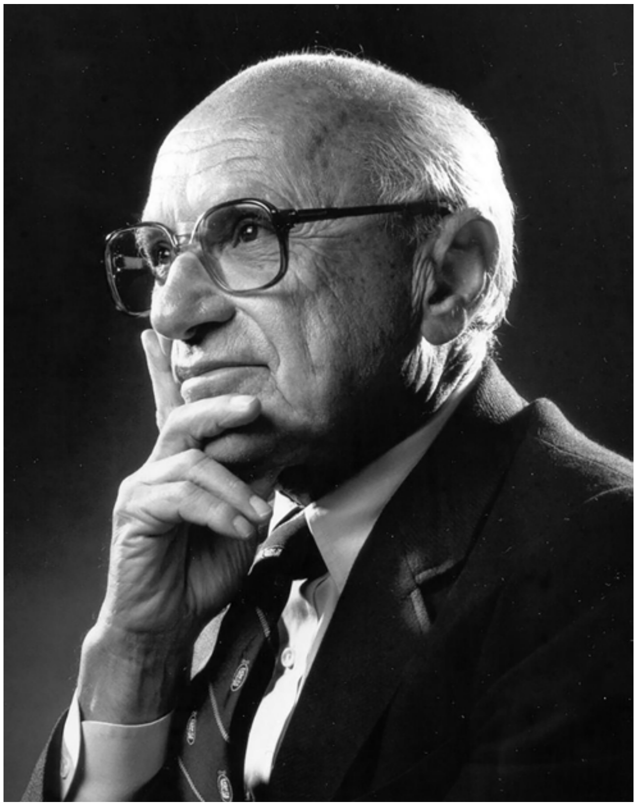
At an event in 2002 in honor of Milton Friedman's 90th birthday, then-Fed Chair Ben Bernanke offered him an olive branch of sorts on behalf of the Fed. "Regarding the Great Depression. You're right, we did it," Bernanke conceded. "We're very sorry. But thanks to you, we won't do it again."

Bernanke's comment was an allusion to the 1963 book *A Monetary History of the United States 1867-1960* by Friedman and economist Anna Schwartz, in which they argued that monetary policy led by the Fed had an enormous influence on the recessionary periods of the U.S. economy, including the Great Depression. That view, although contradictory to the general belief of the time that money had little role in economic fluctuations, became increasingly important and influenced policy responses of the Fed during the 2008 financial crisis.

Throughout his career, Friedman was an advocate for monetarism and free markets. He believed that a stable monetary framework, characterized by steady growth in the money supply, was essential for fostering economic stability and prosperity. Moreover, he considered free markets to be the best way to allocate resources and deliver economic prosperity, and he thought they went hand in hand with individual freedom. These ideas were long out of favor in academic circles but turned out to be another area in which, over time, Friedman would see much of mainstream thought move toward his views.

STARTING A CAREER IN A TIME OF CRISIS

A talented student, Friedman graduated from high school before turning 16 and pursued his college education at Rutgers University. As he was mathematically inclined, he planned at first to major in that subject. Fate intervened in the form of Arthur Burns, a Ph.D. student at Rutgers, who introduced him to the field of economics through his course titled "Business Cycle." (As it would turn out, Burns later became chair of the Federal Reserve Board of Governors and presided over the high inflation of the 1970s.)



Economist Milton Friedman

Burns introduced Friedman to important ideas in economics. First, he introduced him to the theory of the business cycle. Second, he introduced him to Alfred Marshall's ideas, known as marginalism, which describe how the marginal utility individuals obtain from consuming an additional unit of service or goods influences their economic decisions. Burns, impressed with the young student, asked him to proofread his dissertation. Through his interactions with Burns, not only did Friedman learn the practice of scholarship, the bond between the two became increasingly strong, to the point where Friedman regarded him as a "surrogate father" — possibly influenced by the fact that Friedman had lost his father just before entering Rutgers.

While at Rutgers, Friedman was introduced to another important idea in economics through a book by Frank Knight, a professor at the University of Chicago. Friedman was introduced to Knight's work by an instructor at Rutgers who had Knight as his doctoral advisor. In a course on insurance, the instructor used Knight's book *Risk, Uncertainty and Profit,* in which Knight defined risk and uncertainty as separate concepts that can be measured (risk) or cannot be measured (uncertainty) and used them to discuss more fundamental questions in economics, such as, "Why do profits exist?"

Upon graduating in 1932, Friedman decided to pursue graduate education at the University of Chicago in economics instead of his alternative option of studying mathematics at Brown University. The University of Chicago economics faculty at the time was not

IMAGE: THE FRIEDMAN FOUNDATION FOR EDUCATIONAL CHOICE known for its laissez-faire perspective, as it would be in later years. He was also exposed to political questions of the time. The Great Depression, which was then underway, was blamed by many on capitalism itself; there were protests advocating for different social forms such as communism and social democracy while fascism was spreading in Europe, and militaristic Japan was flexing its muscles.

Of that period, economist Allan Meltzer later wrote, “The dominant view then was that capitalism had failed; the future was some form of socialism, and the only issue was how extensive it should be. Keynes wanted free markets for consumer goods but state planning and direction of investment.” Many economists associated market competition with waste, as in the case of multiple milk companies delivering milk to the same block; there was less attention to the benefits competitions can offer to consumers.

After learning that his advisor at Chicago would be away, Friedman decided to spend his second year at Columbia University. Columbia was known for a still more interventionist approach to economics. Economists at Columbia generally thought that the economy would not naturally reach an equilibrium, and that having well-planned active policies by the government was important for addressing economic issues. Attending seminars at Columbia, Friedman was exposed to different ideas on how to address the depression the country was facing at the time. He also added another dimension to his training by taking mathematical economics classes from Harold Hotelling. This was an important step for Friedman since economics research was becoming increasingly mathematical.

As a result of his mixed education at Rutgers, Chicago, and Columbia, by the end of his second year of graduate school, Friedman was exposed to a broad range of approaches to economics, including neoclassical price theory, the quantity theory of money, institutional economics, and mathematical economics. His exposure to different strands of economics as well as his mathematical maturity helped form his foundation. As historian Jennifer Burns put it in her 2023 biography, *Milton Friedman: The Last Conservative*, “The choices before Friedman were clear; he was in an ideal position to chart his own path as a scholar.”

Friedman’s early career was in statistics. In 1935, Friedman, now in his early 20s, got a job as a statistician at the National Resources Committee, a New Deal agency in Washington, D.C. Foreshadowing his later work related to inflation, he was assigned to develop methods to calculate weights for the consumer price index. He then worked for the Treasury in its Division of Tax Research from 1941 until 1943. At that point, Friedman moved to Columbia’s Statistical Research Group, which was directed by Hotelling; there, Friedman assisted in the use of statistics in war-related projects.

THE RISE OF MONETARISM

After his work as a statistician, Friedman took a position at the University of Chicago in 1946 to teach a course in price theory. In the decades that followed, Friedman made major contributions in macroeconomics, while a group of Chicago microeconomists, such as George Stigler and Ronald Coase, challenged then-dominant views favoring government intervention. What emerged from their combined work was a “Chicago School” of thought that highlighted what its members viewed as the importance of individual freedom and limited government interventions for economic prosperity.

While Friedman’s most famous contribution, monetarism, was set out in his 1963 book *A Monetary History of the United States 1867-1960* with Schwartz, it came into its own in the 1970s when it gained influence with policymakers. The book analyzed major economic fluctuations the United States experienced from 1867 to 1960 and described the role monetary policy played in these events. Robert Hetzel, a doctoral student of Friedman’s and a former Richmond Fed economist, observed, “*A Monetary History* was one of the most influential books of the 20th century because of the way it radically altered views of the cause of the Depression.” Both Fed Chair Paul Volcker and British Prime Minister Margaret Thatcher used elements of Friedman’s work to tame the inflation each of their countries was facing in the 1970s to early 1980s.

Monetarism asserts that in the long run, the money supply determines the price level — or, as Friedman put it in 1970, “Inflation is always and everywhere a monetary phenomenon.” (He later clarified that he was referring to persistent inflation.) Thus, in his view, central banks’ objective of price stability would be best achieved by targeting the long-run growth rate of money supply.

Underlying monetarism is a concept called the quantity theory of money, which comes from a simple accounting identity: $MV = PQ$, where M represents money supply, V represents velocity (how often a dollar changes hands), P represents price level, and Q represents quantity of goods and services bought and sold. According to monetarists, V stays relatively constant over time. Thus, changing the money supply would inevitably — mathematically — change the price level. Friedman had been exposed to these ideas at Chicago by Knight and by economist Henry Simons.

The Keynesians, so named for the British economist John Maynard Keynes, had a different view of economic fluctuations and inflation. They did not believe that the kind of monetary policy advocated by Friedman would naturally lead to desirable economic outcomes. Rather, they argued that achieving full employment required the government to use fiscal policy to influence aggregate demand.

These differences in views regarding how macroeconomic equilibrium is achieved and the role of monetary policy had implications for how monetarists and Keynesians looked at the Great Depression. The Keynesians interpreted the depression as an aggregate demand shortfall that was best remedied by fiscal policy. Their influence stimulated the "fiscal revolution" in America, which changed the view of the government budget from a means to support small but necessary government functions to a tool for stabilizing the economy. Friedman and Schwartz, on the other hand, viewed the Great Depression as a monetary policy failure in which the Fed failed to provide banks with necessary cash to avoid bank failures from bank runs.

Another area where Friedman made a notable contribution is the permanent income hypothesis. Drawing upon initial work by economist Dorothy Brady and by his wife, Rose Friedman, he developed a theory and provided supporting empirical evidence that individuals' consumption depends on their long-term income prospects — that is, their "permanent income" — rather than simply their current incomes.

Keynes had earlier argued that as people earned money, they increased consumption, though not by as much as the increase in income. Economists framed the problem mathematically and called the relationship "the consumption function." Keynes asserted that the division between consumption and savings is determined by the disposable income of the person and coined the term "absolute income hypothesis."

Rose Friedman and Brady challenged Keynes' absolute income hypothesis. In a paper titled "Savings and the Income Distribution," they argued that household saving and consumption rates depended on their relative income but not the absolute income within their neighborhood, and this was known as the "relative income hypothesis." Margaret Reid, another economist, also contributed to their research in this area.

Building on this work, Friedman modeled consumption as a function of permanent income and transitory income and through his analysis, he argued that consumption depends on permanent income. He later recalled, "The catalyst in combining my earlier consumption work with the income analysis in professional incomes into the permanent income hypothesis was a series of fireside conversations at our summer cottage in New Hampshire with my wife and two of our friends, Dorothy S. Brady and Margaret Reid, all of whom were at the time working on consumption."

Milton Friedman (right) and producer Robert Chitester during the production of the 1980 television series "Free to Choose."

IMAGE: COURTESY OF FREETO CHOOSE NETWORK/WIKIMEDIA COMMONS

The permanent income hypothesis had fiscal policy implications and clashed with the ideas presented by Keynes. As in the controversy over government interventions to maintain macroeconomic equilibrium, Keynes' theory lent support to government interventions to help economies escape from economic downturns. His absolute income hypothesis suggested that to avoid recessions, governments should transfer money to citizens or increase government spending to boost the income of the recipients to encourage them to spend or invest the money received. The absolute income hypothesis implied that people will increase spending and investment as their income rises, whether temporarily or not. In contrast, Friedman's permanent income hypothesis posits that an individual's consumption is driven by his or her anticipated permanent income; under that view, if governments transfer money or increase government spending to raise the income level of their citizens, and if the citizens regard the increase in income as temporary, then the effect on their spending — and thus on the economy — will be modest. Today, state-of-the-art macroeconomic models incorporate the permanent income hypothesis for some consumers, while allowing for the possibility that borrowing constraints force some households to consume based on their current income.

FRIEDMAN'S OUTREACH TO THE PUBLIC

Beyond his research, Friedman was a highly active and visible public intellectual. He engaged extensively with the public through books and articles and participated in debates and forums. His most notable engagements included his 1962 book *Capitalism and Freedom* and his 1980 TV series "Free to Choose" and its accompanying book.

Through *Capitalism and Freedom*, Friedman advocated the idea that a rising standard of living is a result of the free market. He made recommendations in the book on a wide range of policy issues in areas such as taxation, education, licensing, and exchange rates.

Friedman expanded his reach further when he started writing a regular column for *Newsweek* magazine in 1966. In 1970, in a *New York Times* article, he argued against broad interpretations of corporate responsibility, holding that the main responsibility of businesses is to generate as much profit as possible for their shareholders. He contended that the government is responsible for serving the social interests by taxing the population and providing public infrastructure. Corporations, in contrast, are responsible for doing things that serve the best interest of the company, not of society as a whole.

The "Free to Choose" series came about in the late 1970s, soon after Friedman was awarded the 1976 Nobel Prize in economics. Friedman was approached by a former public television manager, Bob Chitester, with the idea of a program about his economic and social perspectives. The result was 10 unscripted, one-hour episodes in which he discussed topics such as education, protection of workers, and inflation. For example, on the topic of education, Friedman argued that parents having responsibility for their children's education aligns with the tradition of a free society. He argued that elementary and secondary education in the United States should be largely privatized and allow for the development of a for-profit education industry to promote competition in public schools. He maintained that providing a universal education voucher would help bring about the transfer of education from the government to private entities.

"Milton Friedman spent 65 years preparing for that TV series," Chitester recalled. "Every step of his life he had been preparing for that and thinking through ideas, researching them, developing his view of the world."

The television-book approach proved effective: The series drew millions of viewers and the book, co-authored with Rose, was No. 1 on the *New York Times* list of bestselling nonfiction for six weeks.

AN ECONOMIST'S LEGACY

Friedman's research and outreach was consequential for the economics profession and for the country as a whole. Some of the major policies that he advocated were adopted more or less in their entirety, including floating exchange rates, the all-volunteer military, and, in some states and localities, school vouchers.

In macroeconomic policy, the importance of monetary policy to economic stability is widely recognized. This understanding enabled the Fed to bring about the Great Moderation — 40 years of price stability in the United States starting in the early 1980s. (The Fed does not follow Friedman's proposed rule of targeting a rate of growth in the money supply; rather, the Fed — like many central banks — instead targets a rate of inflation.)

Despite Friedman's enormous influence in economics, there are areas in which, even 18 years after his death in 2006, the extent of his legacy is still unclear. Among these is the nature of corporate responsibility: The ideas in his 1970 *New York Times* essay remain controversial, and in recent years, activist investors and others have pushed companies to act on environmental and social issues. The Business Roundtable, a group of large company CEOs, released a statement in 2019 reversing the group's longtime support for principles of shareholder primacy.

On the occasion of Friedman's death, Fed Chair Bernanke returned to the subject of his impact. "Among economic scholars, Milton Friedman had no peer," Bernanke wrote. "The direct and indirect influences of his thinking on contemporary monetary economics would be difficult to overstate. Just as important, in his humane and engaging way, Milton conveyed to millions an understanding of the economic benefits of free, competitive markets, as well as the close connection that economic freedoms bear to other types of liberty." **EF**

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