Turkish Economic Review

www.kspjournals.org

Volume 8 September 2021 Issue 3

Edward Nelson, *Milton Friedman & Economic Debate in the United States: 1932-1972, Volume 1,* University of Chicago Press, 2020, 784 pp. $40.854 Hardcover

***By* Scott Alan CARSON †**

Abstract. Edward Nelson writes an intellectual history of Milton Friedman, who was a thought leader at the University of Chicago. Friedman is mostly known for his work in macroeconomics and policy, but he also did important work in microeconomics and statistics. His macroeconomic demand and supply framework extend into policy, where his work continues to influence economic debate.
Keywords. Monetary policy, Milton Friedman, Economic debate.
JEL. B21, D00, D20, D40.

Book review

The 20th century University of Chicago's economics department is among the most distinctive in the history of economic thought, and Milton Friedman is a singular scholar recognized with the school's methodology. Supported by John D. Rockefellar's fortune, William Rainey Harper gathered to the University some of the most forward-thinking 19th century scholars, and James Mclaughlin attracted leading minds to its economics department. The second period of Chicago economics was with Frank H. Knight and Jacob Viner, whose leading graduate students—Milton Friedman and George Stigler—went on to find the third and most recognized period of Chicago economics (Carson, 2018; Carson, 2019). As soon as the Chicago School was recognized as a separate school, economists and historians have written the department's history, and multiple biographies explore its early contributions. The majority of these history and biographies address the social and personal events of its leading scholars. So far, none of these biographies exclusively focus only on Milton Friedman's ideas and are exclusively devoted to his thinking at the time. However, Edward Nelson—a trained Ph.D. economist—is the first to write a non-biography, intellectual history of Milton Friedman from the perspective of how Friedman's ideas fit within the academic literature of his time in *Milton Friedman & Economic Debate in the United States, 1932-1972* that puts Friedman's work into the discipline's history of economic thought.

† University of Texas, Permain Basin, 4901 East University, Odessa, TX, 79762, USA.
☎. 432-552-2195 ✉. carson_s@utpb.edu

Agree or disagree, Milton Friedman is among his generation's top consequential economic thinkers, and many recent evaluations of Friedman's work caricature, even dismiss, his work as archaic, outdated Neo-Liberalism (Peck, 2010). Although his later popular works align with popular Neo-Liberal thought, the corpus of his work fits into the economic theory of his generation, its scientific methodology, and constructs a macroeconomic paradigm in response to the prevailing orthodox Keynesianism. Ed Nelson integrates Friedman's academic work into the questions of his era, with minimal devotion to his public persona and puts them into the proper academic background.

Milton Friedman is noted for leading early efforts to revive neoclassicism and Monetarism. He is less well known for his work in early microeconomics, statistics, and advocacy of Keynesianism. Friedman began his career working with the US Department of the Treasury, where many theoretical and applied economists followed the prevailing activist Keynesian policies. Friedman—at least for a short time—accepted the early Keynesian perspective, a view that he later rejected. While Friedman's later work primarily addresses the macroeconomic supply-side, Friedman's macroeconomics considered both demand and supply, and from the demand-side, it was his consumption function where he addressed how consumers spend their incomes. The early Keynesian consumption function made little distinction between how consumers spend, and the Keynesian explanation relies on the construct of the marginal propensity to consume, which overstates the effect of consumption with current income. Household income consists of two sources: permanent and transitory income, and households make their long-run consumption decisions with respect to their permanent income, which is planned and expected, rather than their transitory income, which is unexpected, surprised, therefore, volatile. It is this volatile transitory income that makes Keynesian activist demand-side management less effective. Friedman indicated that consumers engage in consumption smoothing, where consumers smooth transitory changes in income over time. Subsequently, consumer's marginal propensity to consume varied over the life cycle and cannot be considered as constant. Friedman's later work with Anna Swartz emphasized the role of money in household consumption decisions, which teases out a causal explanation that it was the money supply contraction that exasperated and made worse the Great Depression.

Within the history of economic thought, there is debate about when Friedman transitioned from the prevailing Keynesian view to monetarism and early neo-classicism. Nelson indicates Friedman emerged as a monetarist in the 1940s, and his later positions regarding inflation, employment, the vertical Phillips Curve, and natural rate changed thereafter. Throughout the 1960s, the Phillips curve provided Keynesian policy advocates with a reliable tool to advocate an inverse relationship between inflation and unemployment. Controlling inflation was a major theme throughout Friedman's career. It was the Federal Reserve that had the greatest influence on the US money supply, and Friedman's primary critique of the Fed was that inflation is always and everywhere a monetary phenomenon. Not satisfied with the prevailing demand-side Keynesian explanation, Friedman and the Chicago School, while initially supportive of Keynesian demand-side management, integrated expectations and supply explanations into business cycle theory.

During the 1950s, Milton Friedman also entered the fray of economic methodology. Whereas, in the early 1900s, a considerable part of the discipline was applied and descriptive, by mid-century, the field had evolved to favor deductive methods. Based on rationalism from the marginalist's and Cambridge School of economics, economists grew more rational, and the value of a model is in the realism of its assumptions. However, reverting to logical positivism in economics, Friedman held that the value of a model is not in the realism of its assumptions but in the success of its predictions. So, Friedman's entrance into economic methodology is consistent with his policy prescription in the importance of a model's forecasts.

The causal explanation for business or trade cycle fluctuations has occupied nearly every generation of economists. The original Classical school held that wages and prices are flexible, and prices and wages adjust to close any gaps, therefore, output deviations between actual and trend are temporary. From the 1940s through 1970s, the prevailing Keynesian view held that wages and prices were rigid and that deviations from trend were prolonged and that output markets are inefficient. Freidman's monetarist perspective is a return to market efficiency espoused by the Classical School. Nonetheless, Nelson emphasizes that Friedman's retreat to the classical flexible price assumption need not hold in the short-run and that the money supply can have real short-run effects. To Friedman—and later Lucas—money is, subsequently, not super-neutral but has short-run effects. However, while Freidman and Lucas are early contributors to neoclassicism, it is not correct that they maintain money has no effect on output and employment. Their rejection of money's super neutrality puts them in opposition to the Real Business Cycle theorists, who hold that money is super neutral and that business cycle sources are technology and government shocks. Nonetheless, Friedman's focus on money and retreat into classical macroeconomic assumptions energized supply-side macroeconomic policies.

Friedman's macroeconomic demand and supply framework extend to policy formation.

Both fiscal and monetary policies have long and variable lags, which led Friedman's views to evolve in the direction on fixed policy rules so that economic agents can plan in a stable policy environment. In a 1949 radio interview, Friedman clarified his view that "any policies the consequences of which depend critically upon the ability to forecast is not a policy which ought to be adopted"[1] which shaped much of neoclassical macroeconomic policy views. This skepticism is indicative of lost faith in activist policies

[1] National Broadcast Company, 1949

and evolved into a series of policy rules in neoclassical thought, such as the Taylor Rule. Forward guidance is another rules-based policy, where the Federal Reserve announces and adheres to its future policies. In the early 2000s, Alan Greenspan's Fed used forward guidance to signal the future path of interest rates. After the 2008 financial crisis, Ben Bernanke and the Federal Reserve emphasized forward guidance throughout the Great Recession. Fed chairs since Bernanke continue to emphasize forward guidance as an effective policy tool.

Friedman influenced exchange rate policy. During the late 1960s and early 1970s, the United States experienced a large gold reserve outflow. Long-time supporters of the Bretton-Woods agreement that established the US Dollar as the World's reserve currency, such as Paul Volcker, held that a stable US Dollar was required to maintain international payments. With his faith in free markets, Friedman boldly advocated the United States adopt a floating exchange rate, and in August 1971, the United States abandoned its Gold Window to no-longer back the US dollar by gold (Carson, 2021). Friedman also advocated for the end of the US military draft, and on December 7th, 1972, the US government issued its last draft call; by April 1st, 1975, the Selective Service was suspended, in part, due to Friedman's efforts to abolish US conscription. His social policy was also consistent with his economics, and the most important of his later economic policies defaulted to individual freedom (Shultz & Taylor, 2020). Subsequently, Friedman's aggregate demand and aggregate supply framework informed his policy recommendations, which on multiple occasions, influenced US macroeconomic and social policy.

As novel as it is, *Milton Friedman & Economic Debate in the United States, 1932-1972* does not address several of Milton Friedman's works between 1932 and 1972. For all his academic demands for physical evidence, Friedman was decidedly non-mathematical compared to the prevailing deductive method. There is a convincing argument that the Chicago School of the later 20th century is a descendant of the later 19th and early 20th century's Cambridge School. However, where Alfred Marshall and the Cambridge School embraced economies of scale and allowed for natural monopolies, Milton Friedman and the Chicago School were pretext for unnecessary government intervention. There are other historical areas were *Milton Friedman & Economic Debate in the United States, 1932-1972* is decidedly thin. For example, the Mont Pelerin Society is discussed in neither volume 1 nor 2 (Carson, 2016). Nonetheless, the book gives fair and extended discussion to opposing views and gives interviews for both those who agree and disagree with Milton Friedman. Writers have to make choices, and with the considerable detail of Milton Friedman's academic work, not all of his contributions can to be included in an intellectual biography.

Beyond Keynes himself, there are few economists during the 19th century who influenced the direction of the field as much as Milton Friedman, and there are multiple biographies and histories that chronicle Milton Friedman's life and the history of the University of Chicago's

Economics Department. While valuable, these texts are less successful in putting Milton Friedman's intellectual ideas into the context of the times, and Friedman's detailed history against the backdrop of the intellectual time. At the November 8th, 2002 University of Chicago's conference to honor Milton Friedman, Ben Bernanke, reflecting on the Federal Reserve's role in the Great Depression, admitted "I would like to say to Milton and Anna: "You're right, we did it. We're very sorry. But thanks to you, we won't do it again." Edward Nelson has written a benchmark history of Milton Friedman's career against the intellectual history of his time. The book is a slow, deliberative examination of his ideas that puts his thinking into context of the time and within the University of Chicago's economics. There is little to criticize and much to admire about Nelson's effort.

References

Bernanke, B.S. (2002). Remarks by Governor Ben S. Bernanke at the Conference to Honor Milton Friedman. University of Chicago: Chicago. Accessed March 5th 2021. [Retrieved from].

Carson, S.A. (2016). The road from mont Pelerin: The making of the neoliberal thought collective. by Philip Mirowski and Dieter Plehwe (Eds.). *Journal of Social and Administrative Sciences*, 3(2), 202-204.

Carson, S.A. (2018). Chicagonomics: The evolution of Chicago free market economics, by Lanny Ebenstein, *Journal of Economic and Social Thought*, 5(1), 111-114.

Carson, S.A. (2021). Keeping at it: The quest for sound money and good government. By Paul Volcker. *Turkish Economic Review*, 8(1), 280-283.

Peck, J. (2010). *Constructions of Neo-Liberalism.* Oxford: Oxford University Press.

Shultz, G.P. & Taylor, J.B. (2020). *Choose Economic Freedom: Enduring Polity Lessons from the 1970s and 1980s.* Hoover Institution Press. Stanford.