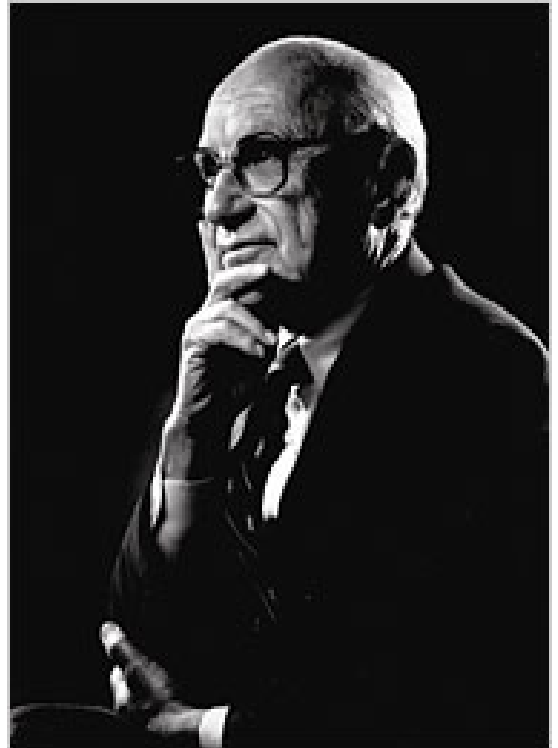


Milton Friedman

1912-2006

- *A Monetary History of the United States* (1963), with Anna J. Schwartz
- *A theory of the consumption function* (1957)
- [Selected Bibliography](#)



Permanent Income Theory of Consumption

- Transitory changes in income do *not* affect consumption spending, only permanent changes do
- This implies a small marginal propensity to consume and, therefore, a small multiplier.
- This makes Keynesian fiscal policy ineffective

Money affects output

- Money supply *does* have a positive effect on employment and production in the short run
 - This is because of “money illusion”.
- Indeed, Friedman argued, the Great Depression was probably caused by a sharp reduction in money supply by the US central bank, the Fed.
- In the long run, however, the quantity of money affects the price level alone

Monetary policy

- But there are lags that make monetary policy ineffective.
 - Observation lag
 - Decision lag
 - Effect lag
- Monetary policy should follow simple rules and not try to adjust to shifting economic situations.
 - In particular, if an economy's GDP normally grows at the rate of 3.5% per year, then its central bank should increase the quantity of money at the same rate every year. This will keep prices stable over the long run.
 - Friedman consequently favored the abolition of the Federal Reserve

Natural rate of unemployment

- In the long run there is no tradeoff between inflation and unemployment.
- Sustained attempts by the government to keep unemployment below the natural rate will lead to accelerating inflation
 - The argument emphasizes the importance of inflation expectations

Flexible Exchange Rates

- Friedman was among those who first realized - and could explain - why the Bretton Woods System with relatively fixed rates of exchange was bound to break down sooner or later.

Libertarianism

- Vigorous participant in public policy debates
 - Had a weekly column in Newsweek, recorded TV documentary series, wrote popular books on economic issues
- Legalization of drugs and prostitution
- Volunteer army
- School vouchers
- Abolition of licensing requirements of doctors
- Negative income tax

Sources

- Chapter X of *New Ideas from Dead Economists* by Todd Buchholz
- Chapter 13 of *The Ordinary Business of Life* by Roger Backhouse; pages 295-8