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OBITUARY MILTON FRIEDMAN

Iconoclastic economist who put freedom first

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1912 - 2006 Free-market thinker

Milton Friedman, who has died aged 94, was the last of the great economists to combine the possession of a household name with the highest professional credentials. In this respect he was often compared to John Maynard Keynes, whose work he always respected, even though he to some extent supplanted it.

Moreover, in contrast to many leading economists, Friedman maintained a continuity between his Nobel Prizewinning academic contributions and his journalism. The columns he contributed to Newsweek every third week between 1966 and 1984 were a model of how to use economic analysis to illuminate events.

Both admirers and detractors have pointed out that his world view was essentially simple: a passionate belief in personal freedom combined with a conviction that free markets were the best way of co-ordinating the activities of dispersed individuals to their mutual enrichment. Where he shone was in his ability to derive interesting and unexpected consequences from simple ideas. Part of his appeal lay in his willingness to come out with home truths that had occurred to many other people who had not dared to utter them. Friedman would then go on, however, to defend these maxims against the massed forces of economic correctness; and in the course of those defences he, almost unintentionally, added to knowledge.

Those who wanted to write him off as a rightwing Republican were disabused by the variety of radical causes he championed. I was not impressed in my own student years by the claims to a belief in personal freedom of the promarket British economists whom I first encountered. It was not until I came across Friedman, and learnt that he had spent more time in lobbying against the US draft than on any other policy issue, that I began to take seriously the wider philosophic protestations of the pro-market economists.

There was indeed nothing of the herr professor about Friedman. A small, voluble figure, he preferred the spoken to the written word and he took well to television. He came to add a good many subtleties to the book, Free to Choose, (which he wrote with his wife, Rose) that were not in the broadcast version. But there is no systematic treatise except some written-up lecture notes outlining Friedmanite economics or even Friedmanite monetary theory.

Those who were won over by his unexpected charm sometimes underestimated his resolve. He would not give a millimetre where his convictions were at stake. Although an unassuming and essentially democratic personality, he was human enough to be aware of, and enjoy, his reputation in the last decades of his life.

Friedman's own career was an archetypal American success story. He was born in New York in 1912 to poor immigrants and his father died when he was 15. He nevertheless studied at Rutgers and Chicago. In the 1930s he was on the staff of various research organisations and began an association that lasted until 1981 with the National Bureau of Economic Research, which sponsored some of his most important work. In 1938 he married Rose Director, herself an economist.

During the second world war Friedman not only worked for the US Treasury on tax but also had a spell in the statistical war research group at Columbia. He became professor of economics at Chicago in 1946, where he remained until his retirement. Friedman's own earliest work was in mathematical statistics, where he helped to pioneer some methods, for instance in sampling, that are still in use.

His first work of wider appeal was a study with Simon Kuznets, published in 1945, of income from independent professional practice. The authors found that state control of entry into the medical profession kept up the level of fees to the detriment of patients. These findings never ceased to get under the skin of the profession.

Friedman's next book, Essays in Positive Economics, published in 1953, contained a famous essay on method. While many other economists were embarrassed by the over-simplified view of human nature in much economic theory, he was characteristically unapologetic. The fruitfulness of a theory, in both the physical and the social sciences, he declared, depended on the success of the predictions that could be made with it and not on the descriptive realism of the assumptions.

One of his famous examples was the proposition that the leaves of a tree spread themselves to maximise the area of sunlight falling on them. The value of the theory depended on whether the layout of the leaves corresponded to this prediction and not on whether the tree made any such conscious effort.

This essay generated a controversy that has consumed many acres of forest. But Friedman, having issued his manifesto, left others to argue about it and was more concerned to apply it in practice. Similarly, in his later expositions of the case for capitalism, he stated his own values and cited corroborative evidence but resisted the temptation to argue about theories of freedom, justice, the state and so on.

I first met Friedman in the 1950s when I was a second-year undergraduate at Cambridge, where he had come on a sabbatical. Unfortunately, I had to share supervisions with another student who had no difficulty in deflecting him into general political conversation. Friedman once arrived early and started to read a copy of George Bernard Shaw's contribution to Fabian Essays, which was lying on the table. "There are three mistakes in the first few pages," he said, referring to Shaw's excursion into marginal productivity theory in which he thought he could instruct less well-read Fabians.

For all Friedman's charm, I received from him one of the best put-down remarks I have ever encountered. He mentioned to me a letter he had received from Arthur Burns (later chairman of the Federal Reserve) saying that Dwight Eisenhower was turning out well as president. I expressed surprise, to which Friedman responded: "First, Burns has much better knowledge of Eisenhower. Secondly, given equal knowledge, I would prefer his opinion to yours."

During the rest of his career, Friedman was largely occupied with the empirical testing of economic ideas. His major achievement was his Theory of the Consumption Function, published in 1957, which was the work most prominently mentioned in the citation for the Nobel Prize that he won in 1976. His investigation was touched off by a wellknown paradox. Cross-section data appeared to show that the percentage of income saved increased as income rose. On the other hand, time-series data showed much less change in the savings proportion over the years. The resolution of the puzzle was that spending and savings decisions depended on people's views of their long-term ("permanent") income; but they were much less inclined to adjust to transitory income variations in either direction.

These findings had at least two implications that Friedman cherished. One was that capitalism did not after all suffer from a long-term tendency to stagnate because of underconsumption. Another was that fiscal fine-tuning would be very difficult, as consumers would ignore temporary variations in disposable income due to government
budgetary tightening or relaxation.

It was in the late 1950s and 1960s that Friedman developed the monetarist doctrines for which he became best known. He treated money as an asset. The public desire to hold this asset depended on incomes, the rate of interest and expected inflation. If more money became available, the effect would be initially to raise real output and incomes, but eventually just to raise prices more or less in proportion. Here was where the famous "long and variable lags" appeared: typically nine months before real output and income were affected and a further nine months before the main effects on prices came through. These time periods were much cited and much derided but they were not the heart of Friedman's message.

The stock response of the antimonetarists was to say that the money supply adjusted passively to events such as wage explosions or government deficits. Although this sometimes occurred, it was important for Friedman to establish that this was not always the case. Sometimes money was the active agent, whether because of an inflow of gold, an official easy money policy, an attempt to maintain a particular exchange rate or whatever.

The book in which he tried most fully to demonstrate money's active role was A Monetary History of the US, 1867-1960, published in 1963 and written jointly with Anna Schwartz. It was one of Friedman's skills that he always found the right collaborator for a particular work. Monetary History is Friedman's masterpiece. Containing hardly any equations, it has been read with profit and pleasure as history, even by people who have disagreed with, or been indifferent to, the doctrines it was designed to advance. Characteristically, it began as a byproduct of an attempt to establish the factual record of the US money supply, which turned up so many problems and brought to light so much new material that the more ambitious volume more or less suggested itself.

The policy conclusion Friedman drew was his famous money supply rule: there should be a stable growth of the money supply, year in year out. He accepted that this was not the only policy that could be derived from monetarist findings. But Friedman himself sometimes gave the impression that whatever a central bank did, it could do no right. To gain his favour it had not only to pursue monetary targets but pursue them by a particular method, known as monetary base control. When the Fed attempted such a method in 1979-82 it was damned for getting the mechanics wrong.

Some economists would argue that Friedman's most important contribution to macroeconomics lay not in his technical monetary work but in his 1967 presidential address to the American Economic Association. Here he demonstrated that the idea of a stable trade-off between inflation and unemployment that held a sway under the name of the Phillips curve and that seemed to give policymakers a menu of choices was invalid.

Suppose that a government or central bank tried to raise output and employment at the expense of accepting higher inflation. Once market participants started to take inflation into account in their behaviour, the economy would end up with the same rate of unemployment as before - but a higher rate of inflation. If the authorities nonetheless persisted in trying to achieve an over-ambitious target unemployment rate, the result would not be merely inflation but accelerating inflation, with which no society could live for long.

This family of Friedman doctrines was sometimes called the vertical Phillips curve, sometimes the accelerationist hypothesis and sometimes the "natural rate" of unemployment. The latter was the level at which the economy would settle once any stable rate of inflation had been established. The name was later changed by some users to the non-accelerating inflation rate of unemployment (Nairu) to banish the idea that there was anything natural or inevitable about it.

It was these ideas related to the Nairu that caused my own conversion from postwar Keynesianism rather than any of Friedman's more technical monetary ideas. The basic propositions are now quite familiar. But at the time they were explosive stuff for the British economic establishment and also for many American economists on the eastern seaboard.

Some economists treated the Nairu as a new technocratic concept that they set about estimating and using for still more sophisticated forms of demand management. This was contrary to the spirit of Friedman's address, where it was obviously intended as a warning against government attempts to spend their way into predetermined levels of employment. The ideas achieved popular currency in the UK, amazingly enough, as a result of James Callaghan's address to the 1976 Labour party conference, when the prime minister warned against believing governments could spend their way into full employment.

All the same it was a little disappointing to those who were interested in macroeconomics rather than monetary technicalities that Friedman did not make more use of the Nairu in his more popular writings. Indeed he sometimes seemed to stretch his own doctrines, in attributing to short-term variations in monetary growth the responsibility for recessions about which he could be as critical as any Keynesian.

Friedman's direct influence on Margaret Thatcher was much less than often supposed. Although they got on together at a private dinner before the 1979 election, the two did not know each other well and Friedman is only mentioned en passant in her memoirs. Her own inspiration, as she relates, came from Friedrich Hayek.

Nevertheless, Friedman had an obvious, if indirect, effect on many of her advisers and ministers. The mediumterm financial strategy of the 1980s, with its target of a gradual reduction in the growth of the money supply and the abandonment of fine-tuning, obviously stemmed at one remove or another from the Chicago economist.

But the master himself disowned the MTFS because the Bank of England continued to regulate the money supply through interest rates rather than via the monetary base. Moreover, he did not believe that reducing the budget deficit would have much effect on interest rates or in any other way deserved the prominence given to it in the MTFS.

On a broader front, however, without Friedman's writings and television expositions, the Thatcher government would not have enjoyed even that very limited degree of approval that it did among a minority of the intellectual elite.

From the late 1970s Friedman lived in San Francisco. He obviously enjoyed his working retirement in this more clement climate, within easy reach of his office at the Hoover Institution in Stanford. Rose, who survives him, was even more delighted with the move.

The very modernity of Friedman meant that he was vulnerable in his technical findings to new researchers claiming to refute his work by still more up-to-date statistical methods. Indeed, Friedman lived long enough to see a reaction against basing economics on discoverable numerical relationships and the revival of so-called Austrian methods, which concentrated on predicting general features of interacting systems on the lines of biology and linguistics. But a methodological dialogue between different schools of free market economists would not have been possible without Friedman's initial dislodgment of the collectivists from the scientific high ground.

In the last couple of decades of his life, Friedman kept his distance from the "new classical economics", which was based on rational expectations and rapid market clearing. He feared that economists were being trapped into a search for mathematical rigour and elegance for their own sake instead of treating them as tools for investigating what was happening.

Friedman himself attributed the spread of both free markets and monetarist ideas to a belated recognition of the consequences of soaring government spending and high inflation in the 1970s. But so far as the reaction was coherent and rational, much of the credit must go to him. The very success of free market policies has, of course, led to fresh problems; and what would one not give for a reborn 30-year-old Milton Friedman to comment on and analyse these new challenges?