Milton Friedman and Economic Debate in the United States, 1932–1972

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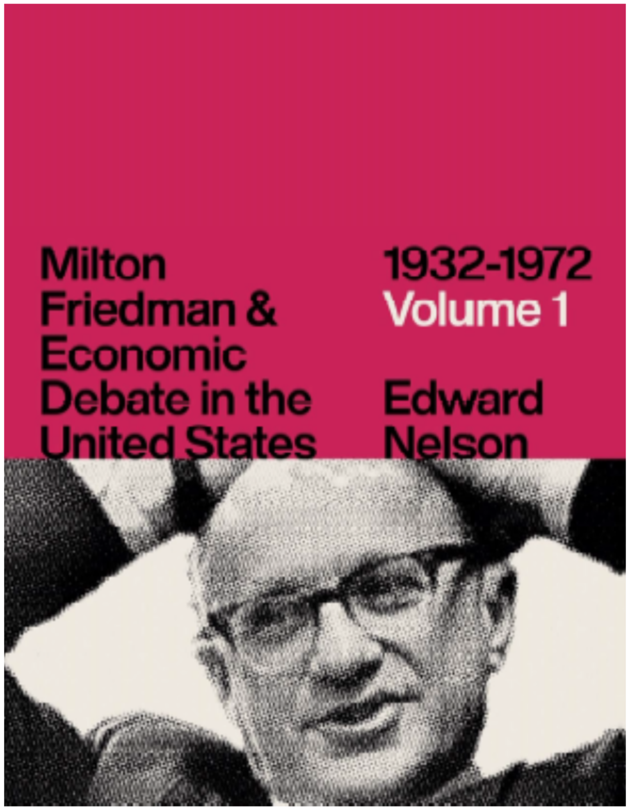

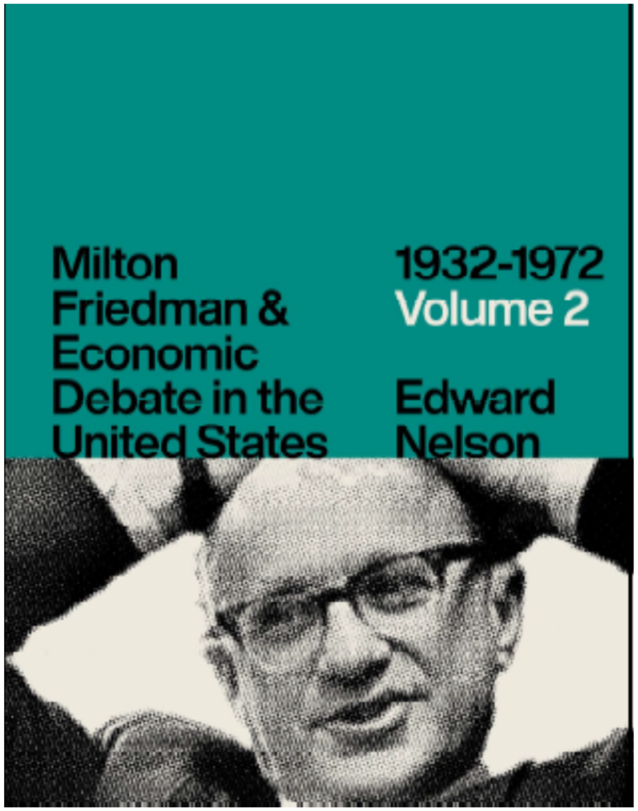

Hoover Institution seminar, February 10, 2021

Views expressed here are the author's and should not be taken as those of the Federal Reserve or the Board of Governors.

AIMS OF THE BOOK

- To analyze, with a monetary-economics focus, the economic debates in which Milton Friedman participated during the heyday of his research career (1932–1972).

- To build a composite picture of the economic model to which Friedman subscribed consistently from the early 1950s onward.

- To present Friedman’s activities in public-policy and research debates over the years as reflecting his adherence to this overall economic model.

REPRESENTING ALTERNATIVES AS MONETARY POLICY RULES

- Meltzer (1983): "Research has shown that every policy is a choice of [a] rule; the only purely discretionary policy is a purely random or a haphazard policy."

- That conclusion remains true today, and it is a message of Friedman's work to frame discussions of alternative policies in terms of different policy rule specifications.

- Friedman cast the debate in the terms of alternative monetary policy rules—so that it was not a matter of policy rules versus *ad hoc* behavior, but a matter of alternative choices of reaction functions or policy rules.

- In particular, Friedman's 1953 article on the effects of a full-employment policy on economic stability would be cited in his Nobel award as part of his work on the complexity of stabilization policy.

- Even the options that Friedman criticized in this paper were policy rules.

- Friedman's 1953 study was also among the first to evaluate alternative macroeconomic policy strategies by reference to a quadratic objective function—a practice that has since become standard.

FOMC CONSENSUS STATEMENT—EXCERPTS
(AUGUST 2020 VERSION, REAFFIRMED JANUARY 2021)

Maximum employment is "**not directly measurable and changes over time owing largely to nonmonetary factors that affect the structure and dynamics of the labor market. Consequently, it would not be appropriate to specify a fixed goal for employment…"**

(*Natural rate hypothesis*)

"The inflation rate over the longer run is primarily determined by monetary policy, and hence the Committee has the ability to specify a longer-run goal for inflation."

(*Inflation's a monetary phenomenon*)

"Monetary policy actions tend to influence economic activity, employment, and prices with a lag."

(*Chair Powell press conference September 18, 2019:*
"we think monetary policy works with, as Friedman said, long and variable lags.")

"The Committee's employment and inflation objectives are generally complementary."

(*Friedman 1952 Congressional testimony:*
"Rather than regarding the objectives of high employment and of price stability as inconsistent, I think that fundamentally price stability will promote a high level of output…")

FORMULATION OF THE REACTION FUNCTION

- The FOMC's consensus statement and related policymaker speeches cast light on its reaction function—as Clarida (2021) elaborates.

- In January, Vice Chair Clarida said in this seminar series that "it will be data on inflation itself that policy will react to" and "policy will not tighten solely because the unemployment rate has fallen below any particular econometric estimate of its long-run natural level."

- It appears that this implies responding to estimated economic slack when employment is judged to be less than its maximum or natural level. But policymakers' criterion for containing **excess demand** has evolved into one centered on the **actual behavior of inflation**, instead of being oriented on an estimated positive output or employment gap (or estimated negative unemployment-rate gap).

- Somewhat echoes Friedman's criticisms (voiced from the 1940s onward) of basing policy on natural-rate estimates or on forecasts. (One he applied in criticizing the late-1950s FOMC tightening.)