

# The impact of Milton Friedman on modern monetary economics: Setting the record straight on Paul Krugman's "Who was Milton Friedman?"<sup>☆</sup>

Edward Nelson<sup>a,\*</sup>, Anna J. Schwartz<sup>b</sup>

<sup>a</sup>Federal Reserve Bank of St. Louis, P.O. Box 442, St. Louis, MO 63166-0442, USA

<sup>b</sup>NBER, 365 Fifth Avenue, 5th Floor, New York, NY 10016-4309, USA

Received 17 October 2007; received in revised form 9 January 2008; accepted 10 January 2008

Available online 19 January 2008

---

## Abstract

Paul Krugman's essay "Who Was Milton Friedman?" seriously mischaracterizes Friedman's economics and his legacy. In this paper, we provide a rejoinder to Krugman on these issues. In the course of setting the record straight, we provide a self-contained guide to Milton Friedman's impact on modern monetary economics and on today's central banks. We also refute the conclusions that Krugman draws about monetary policy from the experiences of the United States in the 1930s and of Japan in the 1990s.

© 2008 Elsevier B.V. All rights reserved.

*JEL classification:* E31; E51; E58

*Keywords:* Monetarism; New Keynesian economics; Inflation; Price controls; Great Depression

---

## 1. Introduction

Paul Krugman's essay "Who Was Milton Friedman?" (Krugman, 2007a) seriously mischaracterizes Friedman's economics and his legacy as well as the legacy of monetarism.<sup>1</sup> Krugman also mischaracterizes monetary policy in the United States in the 1930s and in Japan in the 1990s. In this paper, we provide a

---

<sup>☆</sup>We are indebted to David Laidler and Lawrence White for helpful correspondence on the subject matter of this paper, and to Robert King, Allan Meltzer, Declan Murphy, Mark Wynne, and an anonymous referee for comments on an earlier draft. Justin Hauke and Faith Weller provided research assistance. The views expressed in this paper are those of the authors, and do not necessarily reflect official positions of the Federal Reserve Bank of St. Louis, the Federal Reserve System, or the Board of Governors.

\*Corresponding author. Tel.: +1 314 444 8712; fax: +1 314 444 8731.

E-mail address: [Edward.Nelson@stls.frb.org](mailto:Edward.Nelson@stls.frb.org) (E. Nelson).

<sup>1</sup>Krugman's essay appeared in *The New York Review of Books* on February 15, 2007. Our Letter to the Editor in response to the essay, limited to 750 words by the magazine's rules, and a reply by Krugman, appeared in the March 29, 2007 issue (Schwartz and Nelson, 2007; Krugman, 2007b). Our response dealt only with some obvious inaccuracies in the essay although it alluded to questionable perspectives on technical economic issues in Krugman's commentary. Apart from the space limitations the periodical imposed, *The New York Review of Books* is not an appropriate forum for a discussion of these issues. This rejoinder serves that purpose.

rejoinder to Krugman on these issues. In the course of setting the record straight, we provide a self-contained guide to Milton Friedman's main contributions to monetary policy debates and a picture of his impact on the policies of today's central banks.

We begin this rejoinder by summarizing Krugman's principal misstatements regarding Friedman's body of work and its influence on monetary policy formulation today. Krugman indulges in inaccurate forays into economic history by attributing the depth and duration of the U.S. Great Depression in the 1930s and Japan's extended slump in the 1990s to a liquidity trap, and giving an incorrect picture of the impact of monetarism on monetary policy (Section 2).

In Section 3, we trace the development of Friedman's ideas on inflation, beginning with the record of his opposition to the macroeconomic policies pursued in the United States during the 1960s and 1970s. We also briefly review Friedman's role in theoretical debates on inflation. We highlight differences between the views of Keynesians and those of Friedman. Friedman rejected both the cost-push and the simple Phillips curve approaches that were emblematic of Keynesian 1970s inflation analysis. We then describe the steps leading to Friedman's modifications of the simple Phillips curve and his criticism of Keynesian "patched-up" versions of the Phillips curve.

We next turn to the 1970s debates about price controls as the means of reducing inflation, and show that Krugman's (2007b) statements about the 1970s debate on controls in his reply to our criticisms exhibited further misunderstanding of the importance of monetarist debates and the contribution of monetarism.

We contrast Friedman's view on incomes policies to those of his leading Keynesian opponents (including James Tobin, Paul Samuelson, Arthur Okun, and Walter Heller).

We show that Krugman's assertion that opposition to price controls was common ground among monetarists and non-monetarists is incorrect.

Sections 4–6 then discuss Friedman's further influences on modern monetary policy thinking.

In Section 7, we refute Krugman's claims that a liquidity trap characterized monetary policy in the Great Depression in the United States in the 1930s and in Japan in the 1990s. For Krugman it is enough to note that short-term nominal interest rates are close to or at the zero bound to designate the two episodes as examples of a liquidity trap. He neglects an investigation of the actual motivations of the policymakers involved, and so the factors that account for the policies they adopted; he also understates the scope that was available for achieving a successful monetary expansion.

We conclude the paper in Section 8 with remarks on the credibility of Krugman's portrayal of Milton Friedman.

## **2. Krugman's misstatements in "Who was Milton Friedman?" about Friedman's economics and about monetarism, as well as his assertions of existence of liquidity traps**

### *2.1. On Friedman*

Krugman's (2007a) concluding paragraph states that "Milton Friedman was a very great man indeed—a man of intellectual courage..." This assessment contrasts with the string of negative judgments Krugman makes about Friedman, and particularly about Friedman's work on monetary policy, in the course of his essay. For example, Krugman claims that "[f]rom the beginning, the Friedman–Schwartz position [on the Great Depression] seemed a bit slippery"; that Friedman's post-1963 presentations of the Friedman–Schwartz account "began to seem—there's no other way to say this—intellectually dishonest"; and that "some of the things Friedman said about 'money' and monetary policy... appear to have been misleading, and perhaps deliberately so."

To some readers, Krugman's willingness to praise Friedman despite these accusations might indicate that his essay is balanced; but to us, it shows the degree to which the essay consists of doubletalk. Krugman's accusations constitute such fundamental criticisms that, if accurate, they should be sufficient to rule out a favorable conclusion about Friedman. Specifically: How can he say Friedman was a great economist and a great man, if he believes Friedman to have been intellectually dishonest? Or argue that Friedman was a man of courage, if he misled people?

Download English Version:

<https://daneshyari.com/en/article/967219>

Download Persian Version:

<https://daneshyari.com/article/967219>

[Daneshyari.com](https://daneshyari.com)