

## **Happy Birthday, Milton Friedman**

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Milton Friedman's professional career has been marked by controversy over his many policy proposals. Yet as he approaches his 90th birthday in July, Friedman is increasingly recognized as the most influential economist in a 20<sup>th</sup> century that witnessed towering contributions from John Maynard Keynes, Paul A. Samuelson, and others.

Friedman is best known for "monetarism," a view that stability in the growth of the money supply is crucial to controlling inflation and recessions. Although the relation between the money supply and the economy has often been highly variable, no less an authority than Federal Reserve Chairman Alan Greenspan has indicated that Friedman's emphasis on a stable monetary framework was instrumental in guiding central banks in Europe and the U.S. toward low inflation during the past two decades.

Before Friedman, economic conventional wisdom held that inflation reduces unemployment because prices rise faster than labor costs. In the late 1960s, Friedman argued instead that there is no permanent reduction in unemployment from continuing inflation because wages eventually catch up to prices as expectations about inflation become more accurate. His analysis has been validated twice since then--by the high U.S. unemployment during the 1970s despite rapid inflation, and the low unemployment during the '90s even though inflation was negligible.

Some of Friedman's contributions to micro policy have been fully implemented, such as his persuasive advocacy of a voluntary army while serving on the Gates Commission set up to reconsider the draft after the Vietnam War. At a recent White House event to honor Friedman on his approaching birthday, I discussed a few of his policy proposals that have only been partially adopted and continue to generate controversy.

Two decades before Chile introduced its revolutionary private individual account retirement system, Friedman's classic 1962 book *Capitalism and Freedom* criticized the prevailing pay-as-you-go Social Security systems for restricting the ability of individuals to choose how much and in what form to save for retirement, and for mixing a welfare program for elderly poor with a compulsory program that applies to all the elderly. Had his advice been followed 20 years ago, there would be no impending Social Security financing crisis in the U.S. and other developed nations with aging populations.

In the same book, Friedman showed that without any change in the tax base, a flat income tax rate of 23% could bring in the same revenue as the system of rates that ranged in the 1960s from 20% to an incredible 91%. A few years later, he went further by demonstrating that the flat rate could be reduced to 16% without any diminution in tax revenue if all special deductions for mortgage interest, charitable contributions, and the like were eliminated.

All nations have since brought down their top rates from frequently above 90% to 50% or less. So the world has moved about halfway toward his flat-tax system.

In the early 1950s, Friedman revived the case for allowing foreign exchange rates to be determined by supply and demand for different currencies. Flexible rates had fallen into intellectual disrepute because exchange rates were unstable during the 1930s, and after the post-World War II Bretton Woods Agreement introduced a worldwide system of supposedly fixed exchange rates.

Controversy over flexible exchange rates continues as American political leaders condemn Treasury Secretary Paul H. O'Neill for his refusal to seek a strong dollar. Meanwhile, exporters want him to promote a weak dollar that would make their goods cheaper to other nations. Secretary O'Neill is right in his commitment to let markets decide the international value of the dollar rather than government officials or business leaders with vested interests.

School vouchers is the micro program most closely identified with Friedman. In the 1950s, he first proposed that governments give tuition vouchers to parents with school-age children that they could use at private or public schools of their choice as long as these met education standards. He was confident that even poor parents would generally select a good education for their children if they had real choices.

Although voucher advocates have largely won the intellectual battle, vouchers have been effectively opposed by teachers' unions and by many suburban parents who fear vouchers would encourage poor children to attend schools in their communities. The U.S. Supreme Court will soon decide the legality of several voucher experiments.

Friedman has displayed enormous courage in sticking to his guns after his work was greeted with hostility and, frequently, nasty personal attacks. It must be gratifying to see how much the world has moved toward his positions. We all owe an enormous debt to this great economist as he completes his ninth decade.