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Milton Friedman and Economic Debate in the United States, 1932–1972, Vol. 1 and 2

by Edward Nelson, The University of Chicago Press, Chicago, 2020, 784 + 640 pp., £39 + £44, ISBN 9780226683775 (Volume 1), ISBN 9780226684895 (Volume 2).

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BOOK REVIEW

Milton Friedman and Economic Debate in the United States, 1932–1972, Vol. 1 and 2, by Edward Nelson, The University of Chicago Press, Chicago, 2020, 784 + 640 pp., £39 + £44, ISBN 9780226683775 (Volume 1), ISBN 9780226684895 (Volume 2).

It was a much-awaited work on one of the most influential economists of the twentieth century. The aim of Ed Nelson's two-volume book, *Milton Friedman and Economic Debate in the United States* is to provide an account of Friedman's views in major monetary-policy debates between 1932 and 1972. The outcome is really impressive – not only in terms of the quantity (the bibliography of references totals nearly 200 pages) and diversity of material presented, but also in terms of the author's mastery of the (old and new) literature on monetary-policy issues. Along with George Tavlas's recent book, *The Monetarists: The Making of the Chicago Monetary Tradition, 1927–1960* (The University of Chicago Press, 2023), Nelson's volumes should find their place on the shelf of anyone interested in the work of Friedman – and, more generally, in monetary economics.

The first volume focuses on the years 1932–1950, which the author describes as Friedman's "pre-monetarist years." Of particular interest is Nelson's attempt to show that Friedman had (at least in the back of his mind) a well-articulated framework underlying most of his monetary-policy propositions. The second volume, in turn, focuses on the years 1951–1972 – Friedman's "monetarist period." Most chapters are divided into sections titled "Events and Activities," "Issues," and "Personalities." The "Events and Activities" sections deal with some of Friedman's main positions in the monetary-policy debates during the years covered in the chapter. The "Issues" sections relate to the main policy and theoretical issues with which Friedman was involved during these latter years. Finally, the "Personalities" sections identify individuals with whom Friedman interacted on some of the topics considered in the "Issues" section. This structure proves particularly useful for the reader and should inspire authors contemplating similar work.

The substantial material presented in this book enables the reader to challenge some preconceived ideas about Friedman's work. In the remainder of this review, I would like to concentrate on one of these ideas. It is widely accepted that the positions of Milton Friedman on the Phillips Curve are expressed in his AEA Presidential Address (1968). There, Friedman notably delivers an explanation of the negative slope of the short-run Phillips Curve (i.e., the existence of a short-run trade-off between unemployment and inflation) based on the confusion, by workers, between nominal and real wage movements. The material gathered by Nelson's book suggests (even though its author refrains from drawing such a conclusion) that Friedman was, in fact, never interested in providing a theory for the negative slope of the short-run Phillips Curve (hereafter SRPC). An interview with Stanley Fischer (conducted by Nelson in August 2013) illuminates this contention. Fischer was a postdoctoral fellow in 1969–1970 and then assistant professor, from 1970 to 1973, at the University of Chicago. In the interview, he recounts a lunch with Friedman where they discussed "the micro-foundations of the Phillips curve. And I remember Milton saying, "I really don't see *what* difference it makes who sets prices and so forth. And all this stuff you're busy talking with me about, I'm not sure that it's very important at all'. […] I think he knew there was a (short-run) trade-off, and that was enough for him." (Vol I: 266).

Several instances in Nelson's book support Fischer's inference. To begin with, recall the first paragraph of Friedman's Presidential Address dealing with the slope of the SRPC. Considering the implications of an increase in the rate of monetary growth, Friedman argues that "much or most of the rise in income will take the form of an increase in output and employment rather than in prices. People have been expecting prices to be stable, and prices and wages have been *set for some time in the future* on that basis" (Friedman 1968, 10, italics added). This account of the short-run inflation/unemployment trade-off is in no way specific to the Presidential Address. In a lecture delivered at Baruch College in November 1970, he notably remarked that "Producers set their prices for three, four, five and six months ahead of time, trade unions make contracts for two, three years ahead of time" (Friedman 1970: 4). In Chapter 7 (especially Vol I: 258–69), Nelson shows that, at least until 1972, Friedman typically relied on sticky prices and wages to explain the short-run trade-off.

In the Presidential Address, misperceptions appear in the second paragraph dealing with the SRPC. There, Friedman claims that "real wages anticipated by employees went up, since employees implicitly evaluated the wages offered at the earlier price level. Indeed, the simultaneous fall *ex post* in real wages to employers and rise *ex ante* in real wages to employees is what enabled employment to increase" (Friedman 1968, 10). However, until 1974 Friedman did not refer to misperceptions when he described, on many occasions, the effects of a *decrease* in the growth rate of money supply (devoted to curb the rising inflation of that time). Had misperceptions been crucial for Friedman, he would certainly have used them in this latter case as well.

From 1972 onwards, Friedman gave an increasing role to misperceptions. No longer confined to workers, they concerned all private agents in the economy. Moreover, Friedman's account sounds very much like that of Robert Lucas in his seminal 1972 article. Nevertheless, Friedman would still extensively rely on the existence of pre-determined prices and wages to provide a short-run inflation/unemployment trade-off. For instance, in 1973, he argued that "employment contracts are being made for two or three years in advance […] That's why the first impact (of a slowdown in the rate of monetary creation) is on physical output" (32), while in his Nobel Lecture (1977) he pointed out that the negative slope of the SRPC "can be explained by the impact of *unanticipated* changes in nominal demand on markets characterised by (implicit or explicit) long-term commitments with respect to both capital and labor" (456).

The picture emerging gives credence to Stanley Fischer's assertion: Friedman was eclectic about the explanations of the negative slope of the SRPC, and did not seek to promote any one in particular. The existence of a trade-off between unemployment and inflation was widely recognised by economists, and Friedman did not feel the need to provide an alternative explanation for it. His aim was rather to show that this trade-off was only temporary. Friedman probably knew that his natural rate hypothesis would be polemical. Hence, he considered that his audience would be more willing to accept this hypothesis if this latter was framed within the then popular theory (or theories) of the SRPC. This is why he first stuck to some kind of Keynesian story involving sticky prices and wages, then used Lucas-type misperceptions, but still invoked pre-determined prices and wages at a time when the implicit contract literature gathered momentum. This reminds us that Friedman was, above all, a pragmatic economist.

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