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MILTON FRIEDMAN AND U.K. ECONOMIC POLICY: 1938–1979

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Abstract

This paper analyzes the interaction of Milton Friedman and U.K. economic policy from 1938 to 1979. The period under study is separated into 1938–1946, 1946–1959, 1959–1970, and 1970–1979. For each of these subperiods, I consider Friedman's observations on and dealings with key events, issues, and personalities in U.K. monetary policy and in general U.K. economic policy.

Key words: Milton Friedman, U.K. economic policy, inflation, monetarism, monetary aggregates, interest rates, role of government.

JEL classification numbers: E31; E32; E51; E52.

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1. INTRODUCTION

When invited to comment on United Kingdom economic developments, Milton Friedman frequently prefaced his remarks with a caveat. Thus in 1964 he testified, “I have not followed in detail the current circumstances of the British economy”;¹ while Friedman (2005) likewise stated, “I have no expertise on recent British experience.” But it was rare for him to confine his remarks to this caveat. U.K. economic conditions were an unrelenting source of interest to Friedman, a self-described “life-long student of the monetary and economic experience” of the United Kingdom,² who, as we will see, was as early as 1943 citing speeches by contemporary U.K. policymakers and drawing on U.K. economic data.

In time, Friedman’s influence on U.K. economic discussion would become so pervasive that he was part of the U.K. economic policy debate whether he liked it or not. The fact is that Friedman’s celebrity was proportionately much greater in the United Kingdom than in the United States. The January 1977 issue of the U.K. business magazine *Management Today* referred to the “present controversy, more acute in Britain than anywhere else, over the teachings of Professor Milton Friedman”; and even in 2001, long after the peak of his fame, the London *Independent* newspaper described Friedman as “one of the few economists to have become a household name” (*Independent*, August 28, 2001).³ Moreover, well before he became well known in the United Kingdom (which, roughly, was from the late 1960s onward), Friedman exhibited a Forrest Gump-like tendency to be near the center of events, repeatedly being involved with key figures and incidents in U.K. economic life: his activities included correspondence with Keynes in the 1930s; a visit to the United Kingdom during what Friedman called its peak year of socialism, 1948; a consulting role in the preparations for the prototype version of the European Union in 1950; and sitting in on a Winston Churchill performance in Parliament in 1954.

Friedman’s emphasis on the effects of monetary policy, and his opposition to state intervention in the economy, guaranteed that he would be classified as a marginal figure—if not ignored outright—by U.K. academic and policy circles in the early postwar

¹ From the question-and-answer portion of Friedman’s March 3, 1964, testimony, in Committee on Banking and Currency (1964, p. 1144).

² Friedman (1980a, p. 55).

³ A Bibliographical Appendix gives details for newspaper and periodical articles cited in this paper.

period. Friedman discovered this for himself during spells in the United Kingdom in the early 1950s. The marginal status of Friedman and his positions persisted, with short-lived exceptional periods, well into the 1960s. But, from the late 1960s, Friedman's positions, while still encountering resistance at the policymaking level, became the subject of enormous publicity and scrutiny in the United Kingdom. The control of inflation *was* U.K. political debate from 1968 to 1979, dominating other policy issues over that period in a way that it transparently did not in the United States, where Vietnam, Watergate, and superpower relations competed with, and frequently superseded, inflation in prominence. Friedman's name became part of the parlance in U.K. debate, a fact brought out by the headlines from U.K. periodicals of 1968–79 shown in Figure 1. The degree of Friedman's renown led at the end of the 1970s to the BBC agreeing to broadcast a television series hosted by him, as well as to (inaccurate) speculation that an English town had been partially named in his honor.

Particularly over this most intense period, Friedman made interventions himself on the U.K. scene. He provided commentary on British policy developments during U.K. visits as well as by long distance from the United States. Friedman's U.K. contributions also included some fundamental statements of his positions—most notably his lecture, “The Counter-Revolution in Monetary Theory” (Friedman, 1970a). This lecture, delivered at the University of London in September 1970, was treated by Bernanke (2003) as the most representative statement of Friedman's views on monetary matters, and was what Friedman cited as the place for a list of “some fundamental propositions of monetarism.”⁴

Friedman's contributions to the U.K. scene included several rebuttals to criticisms of his research findings on monetary relations. In 1970 he had stated, “I am so happily blessed with critics that I have been forced to adopt the general rule of not replying to them.”⁵ In light of this policy, the extent to which critics based in the United Kingdom were able to smoke him out, and provoke a direct, published rejoinder from Friedman, is impressive: Nicholas Kaldor in the 1970s, Frank Hahn and Robert Neild in the 1980s, David Hendry and Neil Ericsson in the 1990s.

The fact that Friedman became immersed in debates on U.K. matters, despite his admitted non-specialist status, reflects a pattern found elsewhere in his career. With the

⁴ Friedman, quoted in Snowdon, Vane, and Wynarczyk (1994, p. 174).

⁵ Friedman (1970b, p. 326).

possible exception of the earliest years of his study of economics, Friedman preferred to refrain from using formal economic models; as early as 1954, William Baumol had concluded, “Professor Friedman has always shunned the building of great theoretical systems.”⁶ Friedman recognized, of course, that “it takes a theory to beat a theory,”⁷ that there was a “general theoretical framework that underlies our analysis”⁸ and that economists “can’t do without models... You always have to have some kind of theoretical construct in your mind, and that’s a model.”⁹ But Friedman’s preferred approach was to use single-equation or partial-equilibrium analyses that did not involve specifying a complete structural model and that, in a best-case scenario, might be valid across a variety of alternative assumptions about the remaining equations in the model.¹⁰ But as much as he eschewed formal models, Friedman ended up spending a lot of his time in monetary economics arguing theoretical points, defending his monetary framework against criticism from theorists,¹¹ and in the process was often forced into spelling out in more explicit detail his underlying theoretical framework. In a similar way, Friedman was drawn into the debate on U.K. economic policy despite this not being an area where he felt most in command of details. When push came to shove, Friedman was willing to debate U.K. policy issues just as he was willing to engage in debates on economic theory.

The emergence of the United Kingdom as a major battleground for the debate on Friedman’s views, and particularly on Friedman’s version of monetarism, was amplified by the positions of the leading Keynesians in the U.K. As Cobham (1984, p. 160) observes, “British Keynesianism has traditionally been more ‘extreme,’ more ‘hardline,’ than that prevalent for example in North America.” In particular, in the first several postwar decades, U.K. Keynesians were more inclined than their U.S. counterparts to dismiss altogether the importance of monetary policy. They might deny any effect on

⁶ Baumol (1954, p. 463).

⁷ Friedman used this phrase on two occasions: in the introductory chapter of his *Dollars and Deficits* (Friedman, 1968a, p. 10), and in the *Wall Street Journal*, April 26, 1984.

⁸ Friedman and Schwartz (1970a, p. 80).

⁹ In Taylor (2001, p. 121); see also Friedman’s January 22, 1992, comments on economists having a model underlying their predictions, quoted in Nelson (2007, p. 174).

¹⁰ For example, Friedman and Meiselman (1963, pp. 171–172) specify relations (linking nominal income change to changes in nominal indices) that they intend to be valid under various assumptions about aggregate supply behavior; elsewhere, Friedman stated his preference for empirical evidence that “does not assume any specific model” (in his August 4, 1972, letter to Arthur Burns, CC’d to Anna Schwartz; copy courtesy Anna Schwartz). Friedman’s advocacy of a constant money growth rule was also partly based on the desire to avoid policy responses that incorporated too many assumptions about economic structure.

¹¹ Specifically, from those Keynesian theorists who were thought to have the “technical high ground” over Friedman, in the words of Sargent (1996, p. 540).

monetary policy on aggregate demand; or, if conceding some effect, would be inclined to specify very narrowly the categories of aggregate demand sensitive to monetary policy; and to the extent they conceded that aggregate demand was affected appreciably by monetary policy, U.K. Keynesians tended to dismiss the likely reaction of inflation. The bottom line was that the United Kingdom featured a greater and much longer-lasting “nonmonetary,” or “money does not matter,” brand of Keynesianism. That this viewpoint was the establishment position in U.K. economics up to the 1980s is reflected in the names of those U.K. economists leading the opposition to Friedman and monetarism. Among them were an array of knights and barons: Sir Roy Harrod, Sir John Hicks, Sir Alec Cairncross, Lord Kahn, Lord Kaldor, and Lord Balogh.¹²

Because Keynesianism took a more militant form in the United Kingdom than in the United States, the U.K. debates on monetary policy were more fundamental, and their outcome produced a greater break in the direction of U.K. policymaking.

This brings me to the subject matter of this paper, which is the interaction of Friedman and U.K. economic policy over the period from 1938 to 1979. I interpret this subject broadly to cover debates on policy prescriptions taking place among both economists and politicians. An obstacle to carrying out a study of this kind is that Friedman never published a single, definitive account encapsulating his views on U.K. developments. True, Friedman and Anna Schwartz wrote a detailed study of U.K. monetary relations, their *Monetary Trends* (Friedman and Schwartz, 1982). But while Friedman once made a shorthand reference to this book as a study of “U.K. monetary history” (*Wall Street Journal*, February 12, 1987), the volume was not, in fact, a U.K. counterpart to Friedman and Schwartz’s (1963) *Monetary History of the United States*. Rather, its focus was on the quantitative analysis of longer-term economic relations, with Friedman and Schwartz (1982, p. 605) acknowledging, “We have not made a similarly exhaustive study of United Kingdom monetary history.” *Monetary Trends* does contain along the way many observations on U.K. developments that are relevant to the present paper and that are incorporated into my discussion below. But the book is not a sufficient statistic when it comes to studying Friedman’s views on U.K. economic developments; it does not contain most of Friedman’s observations on the year-to-year course of U.K. economic policy. For that, one must turn to other places.

¹² After 1979, as governments more sympathetic to monetarism took charge of the honors system, the tables were turned, and some of the U.K. monetarist writers received titles: Sir Alan Walters, Sir Samuel Brittan, Lord Griffiths, etc.

The Debate over Money Supply

What Milton Friedman Means for the Boardroom

MV = PT Again?

THE IMPLICATIONS OF MILTON FRIEDMAN FOR BRITAIN

Yo-Ho-Ho and a money

ES had another bad day and
iment stocks slid to new lows as
people came to agree with my
nat, as far as the squeeze goes,
n't seen nuffin' yet.

supply!

part of the supply but it can be
got at. TDO and, in a real
square, would be "velocity"
counts on. That is, the speed
with which the money goes out
credit cards have helped to
speed it up.
But, with, to all hands, this
what is going to happen. At

SHARE OF
THE DAY

weekly a 4th
This company
£8,740,000 amount
£2,599,278. The
up from £1,352,4
P.C.
Morgan, then
well, which will

FRIEDMAN ON

The only way to halt inflation

Healey's Budget won't
work, says Friedman

Does Money Matter?

Help to stop Friedmanism Milton Friedman looks into Britain's crystal ball—and doesn't like what he sees

Figure 1. Selected U.K. headlines, 1968–79

SMILING MAN OF WOE Monetarism
'is making
crisis worse'

THE man who forecasts doom for
Britain runs from a humble bank
ground to become one of America's
top economists.

By NICHOLAS BASKIN
Chief Foreign Editor

An open letter to Professor Friedman

An open reply from Milton Friedman

The Nobel Milton

City fears softening
of monetarist line

**THE FRIEDMAN
PHENOMENON**

Help stamp out
Friedmanism

Is money really all
that matters?

Even today, you can
understand why the
world has to be the
best, that is to say, the
best, with the money supply
of all the nations, which

THE
MONEY
SUPPLY
DEBATE

WHAT FRIEDMAN REALLY THINKS
OF BRITAIN

Figure 1 (cont.). Selected U.K. headlines, 1968–79.

And, for a comprehensive account, this means looking at a lot of places. Friedman's remarks are widely dispersed across time and location. Not only his writings but also many interviews are relevant, as they frequently contain, in the words of Friedman and Schwartz (1982, p. 623), "illuminating side comments" on U.K. economic matters. And of those interviews Friedman gave in which the United Kingdom was the major topic, many were in U.K. newspapers which have been neither indexed nor electronically archived.

At first sight, the multiplicity of sources might not seem too troublesome: perhaps, it could be argued, there are only a few basic Friedman references, the remainder being repetition and propagation of his key work. It is true that in the course of countless lectures, writings, and interviews, Friedman repeated himself on every dimension: on the points he made, the historical examples he cited, the analogies he drew, the anecdotes he related. Putting aside actual reprints, the repetition is most evident in the considerable number of his writings which include extended quotations from previous work. Even the largely new Friedman-Schwartz *Monetary Trends* opened its concluding chapter with a lengthy excerpt from a 1972 Friedman paper. And in his 1992 book *Money Mischief*, Friedman only makes it through six lines of text before deploying a quotation from an earlier book of his. On one occasion, Friedman, employing a stop-me-before-I-kill form of words, acknowledged this practice: "I'm sorry to quote myself all the time, but I can't help it." (*Fortune*, March 19, 1984.)

Notwithstanding the heavy repetition, there is usually some marginal contribution—perhaps an added observation, or an update or qualification to previous analysis—even in those works of Friedman that drew most heavily on his previous writings. In other words, while Friedman repeated himself often, he rarely repeated himself *completely*. It would, furthermore, be misguided to think that Friedman's most relevant observations on a particular subject appeared in his most prominent journal publications or in his most widely-cited articles. If anything, the opposite is the case. This reflects the pattern summarized by Johnson (1974, p. 346) as Friedman's "life-long habit of scattering his new empirical results and ideas in unlikely places." Friedman's tendency to "fractionate" his written output by spreading it across an enormous variety of outlets means that, to obtain the full picture, one has to reconstitute the record from this very wide base.

I have carried out such a reconstitution for this study. The deployment of extensive source material is a principal contribution of this paper. The research here is based on an

analysis of Friedman's publications, including many articles neither appearing in his book collections nor available electronically; his op-ed contributions; his published interviews in newspapers, magazines, and journals, as well as my own meetings with him; and much unpublished material. I have built a database of Friedman's public statements, based on my six years of microfilm reel searches, on physical inspection of hard copies of newspapers, on information from search services offered by companies and by newspapers, and on searches of newspaper and other databases that are publicly electronically archived. My search through Friedman correspondence included examination of samples from the Hoover Archives' catalogued correspondence and of correspondence yet to be catalogued by the Archives,¹³ and my own correspondence with Friedman from 1991 to 2006. Only by sewing together this crazy-quilt of sources is it possible to obtain a comprehensive account of Friedman's views on and connections with U.K. economic policy.

Also, crucially, I draw extensively on material (both correspondence and memoranda) provided to me by Anna Schwartz from her own files.¹⁴ As well as (obviously) covering much of her work with Friedman on monetary policy generally, these files cover such U.K.-relevant material as Friedman's lecture to the London School of Economics in May 1952, and documents outlining the making of their *Monetary Trends*.¹⁵ I use Congressional testimony and submissions Friedman gave, including several items not included in his comprehensive published bibliographies. I also draw on transcripts of television interviews Friedman gave in the United States and the United Kingdom in the 1960s and 1970s that have been infrequently, if ever previously, cited.

The approach undertaken in this paper sets it apart from the sparse previous work specializing on Friedman's relationship to U.K. economic policy. Two papers covering this subject are the chapter of Frazer (1988) entitled "The British Connection," and the chapter of Parsons (1989) entitled "How Friedman Came to Britain." The present paper differs greatly from these earlier works in content as well as source material. I

¹³ I am indebted to Friedman's secretary, Gloria Valentine, for fulfilling my requests for information about as-yet-uncatalogued Friedman files prior to her retirement in 2007, as well as answering many inquiries from me on the subject matter of this paper.

¹⁴ As well as for the generous access she granted me to this material, I am indebted to Anna Schwartz for answering numerous inquiries on the subject matter of this paper. This includes responses to specific inquiries I made during the course of writing this paper and, more generally, information conveyed in assorted correspondence, conversations, and meetings with me from 1991 onwards.

¹⁵ Where known, I also identify, for the Friedman-Schwartz correspondence, the location of the corresponding copy of the material in the Friedman papers at the Hoover Archives.

extensively cover 1938–68 developments, whereas both these authors essentially begin their coverage in the late 1960s. Moreover, my greater attention to U.K. economic policy permits a thoroughly different look at the 1970s. For example, the coverage of Friedman’s statements on the United Kingdom in Frazer’s “British Connection” chapter draws primarily on the standard articles later reprinted in Friedman (1991), as well as an interview Friedman gave to *The Times* in 1976.¹⁶ Frazer does not mention many of the key figures in pre-1979 U.K. policymaking—for example, there is no mention of Harold Macmillan or James Callaghan, whose governments together made up a decade of the postwar period—and he provides no detailed discussion of the pre-1979 governments’ policies. This contrasts with the detailed coverage I give of postwar U.K. economic policies and their relationship to Friedman’s research and public policy activities.

In terms of use of pre-1980 material on Friedman in the U.K. press, Frazer’s book in total draws only on a few items from *The Times*, the *Times Educational Supplement*, the *Sunday Times*, and *The Economist*.¹⁷ These happen to be the easiest U.K. publications from which to retrieve articles because published indexes of these newspapers exist, leading to straightforward retrieval of the Friedman-related items.¹⁸ But to rely on this material is to leave out an enormous amount of material germane to the study of Friedman and U.K. economic policy. My own base of U.K. material on Friedman includes many more U.K. newspapers and periodicals, due to my inclusion of newspapers and financial periodicals for which neither indexes nor electronic search systems exist. For example, my source base includes items from the *Financial Times* from 1945 to 1981 obtained through my exhaustive search of microfilm and hard copies of the *FT* over this period, a period over which no index or digital archive of the *FT* exists. This coverage contrasts with that in Parsons (1989), whose chapter on Friedman principally cites *The*

¹⁶ There is also limited use of U.K. press material from the 1970s in Frazer’s chapter “The Thatcher Government,” as discussed in the next footnote.

¹⁷ Aggregating Frazer’s (1988) “British Connection” chapter and his subsequent chapter “The Thatcher Government,” and excluding citations of *The Economist*, there are only five cited U.K. press articles for the pre-1980 period covered in this paper: one from 1975, two from 1976, one from 1977, and one from 1978. (The reference list in Frazer (1988, p. 784) gives two *Times* articles for September 1978, but one of these is actually an erroneous repeat of the 1976 citation.) Nor are any of Frazer’s citations of *The Economist* for articles dated before 1975. One pre-1975 U.K. press citation does seem to be present in Frazer (1988), as his “Thatcher Government” chapter provides what is said to be a quotation from “the *London Observer* (10/10/72)” (Frazer, 1988, p. 577). But the quotation Frazer gives is not retrievable from the historical electronic archives now available for *The Observer*; and in fact there was no edition of *The Observer* of October 10, 1972, that date being a Tuesday and *The Observer* being a Sunday newspaper.

¹⁸ In addition, microfilm copies (for *The Times*) or hard copies (for *The Economist*) of these items are held widely in libraries outside the United Kingdom. In the 2000s, searching these publications has since been made easier still by the appearance of digitized historical archives of *The Times* and *The Economist*.

Times and *The Economist* from the pre-1980 U.K. press; the one pre-1980 *Financial Times* article, and pair of 1974 *Daily Telegraph* articles, cited by Parsons, did not require archival retrieval from the original sources because they were available in reprint form in 1970s book collections.

My extensive search further implies that I am able to draw on the large volume of interviews Friedman gave to the British press in the 1970s that have not been incorporated into previous studies, including those he gave to *The Guardian* (in 1974), the *Daily Mail* (in 1974), and the *Daily Express* (in 1976), as well as many U.S. writings and interviews, not dealt with by earlier authors, containing Friedman's views on the United Kingdom. In the course of my research, I have retrieved several publications by Friedman in the U.K. press that do not appear in his published complete bibliographies (Thygesen, 1977, and Leube, 1987) and so have been missed in accounts based on the same information as these bibliographies.¹⁹ And, as noted above, I draw heavily on transcripts of television interviews given by Friedman.

As far as content is concerned, neither Frazer nor Parsons worked extensively in the research field of U.K. economic policy, and this is reflected in errors in their accounts and in some puzzling omissions and choices for inclusion. For example, Frazer's account contains errors in its presentation of Friedman's monetary theory; has numerous misstatements of dates and facts; and makes ill-founded attempts to establish that the work of David Laidler (one of only two major figures in the U.K. debates to have a background as a Friedman student) was in the pre-Friedman Keynesian tradition. Parsons' (1989) discussion accepts the popular misconception that John Kenneth Galbraith was a leading protagonist in the Keynesian-vs.-monetarist debate. These considerations reinforce the conclusion that a thoroughly new look at Friedman's interaction with U.K. economic policy is desirable.

The remaining discussion in this paper is divided into chronological segments. For each segment, I consider the main U.K. economic events and Friedman's interaction with

¹⁹ For example, Hammond (1996, p. 193) states, "In the 1970s, Friedman published two letters to the editor in *The Times*." In fact, Friedman published four letters to *The Times* in the 1970s. Friedman's official bibliography (see Leube, 1987) does list only two, dated 1977 and 1978, and these are the two referenced by Hammond. But I have located two earlier (1972 and 1973) *Times* letters by Friedman that did not appear in his official bibliography. In addition to his London *Times* pieces, Friedman made contributions to the *Sunday Telegraph* and the *Financial Times* that were not listed in his bibliography and so were not included in Hammond's list of Friedman's U.K. contributions, but which are discussed in this paper.

them; then, particular issues brought up in each period; and finally, the key personalities of each period and Friedman's interactions with, or observations on, them. Brief concluding remarks and a bibliographical appendix complete the paper.

2. 1938–1946

EVENTS, 1938–1946

In 1938, Milton Friedman, 25, was based in New York City at the National Bureau of Economic Research, where he was working primarily on completion of his dissertation. His dissertation work came under the umbrella of what would subsequently be called microeconomics, but Friedman also kept up with the literature on monetary policy and business cycles. It was in this connection that, as he told Brian Snowdon and Howard Vane, "I bought [*The General Theory*] in 1938 and paid a dollar and eighty cents for it."²⁰

Friedman's recollection was that he was "if anything[,] somewhat hostile" to the *General Theory* (Friedman 1972a, p. 936), and that he was influenced by the fact that among older economists there had been "a good deal of skepticism and dissatisfaction" in response to the book (Friedman, 1982a, p. 9). Moreover, of the younger economists closest to Friedman, Arthur Burns expressed reservations about the novelty of the *General Theory*, later contending that he had favored expansionary measures "as early as 1930, before Keynes' theories were known."²¹

Unlike the initial skeptics, Friedman did not deny the novelty of Keynes' theoretical contribution. The *General Theory*'s explanation for the Depression and its rationalization for fiscal expansion, Friedman would conclude, were *not* merely restatements of preexisting ideas; he would credit Keynes with a "rigorous and sophisticated analysis" (Friedman, 1968b, p. 1) that provided "a new, bold, and imaginative hypothesis" (Friedman 1972a, p. 908).

Friedman did share with many critics the concern that Keynes' book would be seen as giving the green light for a permanent increase of the size of government. To these critics, Keynes was providing a respectable theoretical rationalization for extensive

²⁰ In Snowdon and Vane (1997, p. 195).

²¹ Burns, October 2, 1975, testimony in Committee on the Budget (1975, p. 170). Friedman described Burns as "really my mentor" during Friedman's early career (CSPAN, November 20, 1994).



Figure 2. Milton Friedman, January 1992. (*Photograph taken by author.*)

government intervention, through his depiction of the income-expanding effects of government purchases and his characterization of private investment demand as destabilizing. In addition, Friedman later argued that the underemployment-equilibrium argument in the *General Theory* was “highly congenial to the opponents of the market system” (Friedman and Schwartz, 1982, p. 43), and approvingly quoted a 1948 observation by his brother-in-law that “Lord Keynes provided a respectable foundation for the adherents of collectivism.”²² Friedman’s verdict at the end of the 1970s was that the idea that “deficits... were a way of expanding the economy” led to a “tremendous

²² Director (1948, p. v), quoted in Friedman (1985, p. 17).

growth in government spending” (May 17, 1979, testimony, in Committee on the Judiciary, 1980, p. 149).

These misgivings about the perceived policy implications of the *General Theory* reflected Friedman’s free-market, small-government attitudes, already entrenched by 1938. Friedman assessed in retrospect that “I was mildly socialistic” before graduate study (*Newsweek*, June 15, 1998). But he had been converted to free-market attitudes during the portion of his graduate studies that he took at the University of Chicago²³—“an excellent Department of Economics, I think the greatest in the country, even before I was there.”²⁴

Friedman and Schwartz (1982, p. 621) would later group this period in what they called the “troubled interwar years.” Beside depression, the other major sense in which these years were “troubled” is obvious from the “interwar” label. What Friedman in 1938 called “this damn European situation²⁵ led to the United Kingdom going to war in September 1939. Following the United States’ entry into World War II in 1941, Friedman joined the U.S. Treasury. He later said that his Treasury colleagues and superiors saw him as a “starry-eyed theorist.”²⁶ This being the case, it was as a Keynesian theorist, for Friedman had largely accepted the theoretical contribution of the *General Theory*. In particular, he embraced its skeptical perspective on monetary policy. Anna Schwartz has described this period in Friedman’s career as “before he was a monetarist,”²⁷ and Friedman went further in a television interview in 1994: “when I was at the Treasury, I was essentially a Keynesian, as I believed that the way to control inflation was by controlling government spending. I paid very little attention to money.” (CSPAN, November 20, 1994.)

²³ For example, Friedman (1976a, p. xxi) acknowledged, “I was influenced in this direction by my teachers at the University of Chicago.”

²⁴ *Milton Friedman Speaks*, Episode 8, p. 30 of transcript. *Milton Friedman Speaks* was the name given to a series of Friedman talks in the United States videotaped over 1977–78, and used to promote interest in a projected television series for Friedman; see Friedman and Friedman (1998, pp. 477–478, 604). The series was released on a limited basis on videotape, accompanied by official transcripts, in 1980, and were more recently repackaged as a commercially available DVD set. References made in this paper are generally to the transcripts, but all the quotations from the transcripts also appear on the DVD releases.

²⁵ March 17, 1938, letter from Milton Friedman to Rose Friedman, quoted in Friedman and Friedman (1998, p. 77).

²⁶ *Newsweek*, July 24, 1978; and Friedman and Friedman (1984, p. 50 of U.S. edition; p. 53 of U.K. edition).

²⁷ Anna Schwartz, remarks at HOPE conference, Duke University, April 2003.

The Keynesian perspective is so clear in Friedman's early 1940s writings that monetarists such as Laidler (2003) have marveled at the contrast with Friedman's later work. Friedman expressed a similar sense of surprise when looking at the 1940s work from the vantage point of three decades later. "In a note on the inflationary gap that I published in 1942," Friedman said in a November 1971 talk (Friedman, 1972a, p. 183), "I never mentioned the quantity of money or monetary factors at all!" A further three decades on, Friedman continued to reproach himself: "I look back at that and say, how the hell could I have done that?" (In Taylor, 2001, p. 118.)

One by-product of the Keynesian revolution's downgrading of monetary policy was to put Friedman in a terminological dilemma. The term "macroeconomics" sprung up in the 1940s, and Friedman on many occasions expressed his dislike for this term (e.g., Friedman, 1975a, p. 176; Friedman, 1976b, p. 7; and in Taylor 2001, p. 111), and his preference for the label "monetary theory." Yet many, Friedman among them,²⁸ took the view that a main point of Keynes' *General Theory* was to provide a *nonmonetary* interpretation of the collapse in output, and to promote an instrument—pure fiscal policy—whose effects on aggregate demand were said to be reliable even in circumstances where monetary actions allegedly could not be counted on to be effective. But how could such a nonmonetary body of thought be classed under "monetary theory"? Friedman's resolution of the dilemma was indeed to file the nonmonetary aspects of Keynesian theory under "monetary theory," but to refer to "monetary theory and analysis, narrowly interpreted" when referring to research that emphasized the quantity of money (Friedman 1968c, p. 438).

The Keynesian position that there was a region where money and income had a very loose relationship with one another was, to Friedman, seemingly confirmed by his look at data. His (1943) paper on inflation, written while at the Treasury, plotted growth rates of nominal money and nominal income for the USA for 1899–1929; the plot led to Friedman's judgment that the relationship was "extremely unstable."²⁹ This judgment seems untenable. Simple inspection of the scatter plot in Friedman's paper (Friedman, 1943, p. 121) indicates that the money growth/income growth relationship is clearly positive, and reasonably tight by the standards of rate-of-change data.

²⁸ E.g., Friedman (1970a; 1972a, p. 908); Friedman and Schwartz (1982, Sect. 2.5 and Ch. 12).

²⁹ Friedman (1943, p. 119). Friedman contrasted this with what he called the "considerably more regular" empirical relation between consumption and income, which supported Keynesian theory (1943, p. 120).

Friedman also embraced some of Keynes' post-*General Theory* ideas, notably those in Keynes' *How to Pay for the War* (1940). Friedman's contribution to "inflationary gap" analysis was in this tradition. This work (Friedman, 1942, 1943) revealed a close following of U.K. developments, in keeping with Friedman's later assessment that the United Kingdom was at that time still the center of economic research.³⁰ Specifically, Friedman (1943) discussed "recent English discussion of fiscal policy [that] has centered on the so-called 'inflationary gap,'"³¹ discussed U.K. gap estimates made by British economist Frank Paish, and cited a 1943 House of Commons speech by the Chancellor of the Exchequer, Kingsley Wood, a speech known to have been drafted by Keynes (see Samuelson, 1946).

"Inflationary gap" analysis had in common with Friedman's later work the portrayal of inflation as demand inflation. The details of how inflation emerged, however, were different in his 1940s analysis. Inflation in this analysis was seen as serving to equalize the nominal value of potential output and the nominal volume of aggregate spending. Potential output was assumed to have a physical ceiling, so that price change took up all the excess spending above this maximum. There was, in contrast to later Keynesian and monetarist work, no allowance for "overfull employment." Reflecting his later use of the overfull employment concept, Friedman would say in 1972, "I think people are wrong in supposing that there is a rigid ceiling on output such that further increases in real output are impossible... It is possible to have overemployment as well as underemployment."³² In postwar work, Friedman and others would accordingly distinguish carefully between potential and maximum output.³³ In particular, the notion that output could *temporarily* exceed potential, and unemployment fall below its natural rate, was a contribution of Friedman's natural rate hypothesis (e.g., 1968b, 1977a). Nevertheless, the concepts of positive output gaps, and associated overfull employment, were innovations neither of Friedman nor of the Phillips curve literature; they were in place earlier than the 1950s

³⁰ See his remarks in Snowdon and Vane (1997, p. 205).

³¹ As this quotation and many others in subsequent decades indicate, Friedman often used the terms "English" and "British" interchangeably. In addition, he frequently used "England," "Great Britain," and "Britain" as synonyms for "United Kingdom," even though, strictly speaking, only "Britain" is, in fact, a valid synonym for the United Kingdom. On the other hand, for an occasion when Friedman used "Britain" but meant the part of the United Kingdom excluding England, see his article in *Financial Times*, December 18, 1989, and the corrected text of the article in Friedman (1992, p. 243).

³² Friedman (1973a, p. 35).

³³ Friedman would still believe that there was a physical ceiling on output (see the expositions of his plucking model in Friedman 1964a, 1993), but he no longer treated this ceiling as synonymous with the natural level of output.

and 1960s. The possibility that overfull employment could occur was specifically embodied in the U.K. policymaking framework by the late 1940s.³⁴

“During World War II,” Friedman later recalled, “governments everywhere had largely assumed control of the economy. And it was simply almost taken for granted that they would have to continue to do so in the postwar period.”³⁵ The Attlee Government was elected in the U.K. general election of July 1945. Friedman noted, “In Britain, the Labour Party’s postwar victory over Winston Churchill spelled a commitment to central planning.” (*Newsweek*, July 14, 1975.)

ISSUES, 1938–1946

NATIONALIZATION AND CENTRAL PLANNING

Friedman observed that the postwar shift to greater government economic control had been justified on efficiency grounds: it was believed “that centralized and comprehensive economic planning and control by government is an essential requisite for economic development” (Friedman, 1958a, p. 505). He noted that, in particular, nationalization of industries was motivated by this consideration (*The Listener*, April 27, 1978; *San Francisco Chronicle*, April 3, 1979). The Attlee Government utilized the efficiency argument when implementing a broad nationalization program after it came to power.

This nationalization program was believed to be appealing to U.K. electors, to judge by the notice of their plans that leading Labour politicians gave in the months approaching the election. Herbert Morrison, who would serve as effective deputy Prime Minister under Attlee, said in 1944: “We have now reached the point where the case for nationalization rests not upon any doctrinaire, preconceived ideas, but upon the hard, inescapable facts...” (*News-Chronicle*, December 4, 1944.) Stafford Cripps, later Chancellor of the Exchequer, said, “We must replace the libertinism of private enterprise by a planned system of economy which calls for a considerable measure of state control

³⁴ See Nelson (2009). Some have argued that Keynes himself used the notion of overfull employment (though not that terminology) in the 1940s. For example, Day (1968) and Robbins (1960) characterize Keynes’ position in that manner; a *Financial Times* article (July 5, 1974) referred to “the Keynes-Beveridge distinction between full and overfull” employment; and a correspondent to the *Financial Times* went so far as to say that in his own conversations with Keynes, Keynes had “suggested that there was an equilibrium or ‘natural’ rate of unemployment” (*Financial Times*, March 5, 1975).

³⁵ Quoted in Levy (1992).

and ownership.” As did many in the West, Cripps cited the Soviet Union as a successful economic model: “In Russia you have a State-planned and controlled industry, and I cite this as an example to show that some form of centralized planning and control helps and does not retard efficient production and full employment.” (*News-Chronicle*, December 18, 1944.)

The nationalizations undertaken by the Attlee government (1945–51) encompassed mining, communications, the railway system, and steel.³⁶ It was a long list, but Friedman had anticipated that a still more comprehensive nationalization scheme would be carried out. He observed in 1972 of the late 1940s, “If you had asked us then about the health of capitalism and free enterprise 25 years later, I think we would have said it would be closer to its deathbed than it actually is now.”³⁷

In fact, Friedman’s 1950s writings (e.g., 1958b) and his 1962 *Capitalism and Freedom* contain remarks to the effect that he thought that in the United Kingdom the move toward greater government intervention had peaked even before the Attlee Government left office. In particular, Friedman took comfort from the fact that central planning, as opposed to nationalization, had not endured in Western economies beyond the 1940s. Detailed direction of resources, public and private, had been foreshadowed by the Attlee Government; as Friedman noted, “immediately after World War II, it was thought that the government was going to get involved, especially in Britain... in central economic planning on a large scale.”³⁸ Efforts to replace the price system with government direction of allocation decisions had, he argued, faltered and led to socialism peaking in the United Kingdom in 1948 (*Vision*, April 1972). Friedman (1962a, p. 11) singled out the fate of the Attlee Government’s Control of Engagements Order, which, he said, would have meant a directed-labor economy if it had been enforced. The Order was not in fact enforced heavily and was then repealed, an event Friedman identified as a “turning point” (Friedman, 1962a, p. 11) when “central planning came to a screeching halt” in the United Kingdom.³⁹ Thus Friedman (1958b, p. 34) offered the assessment that “in Britain and in many other countries, central planning has given way...”

³⁶ See Childs (2006, p. 14) for a tabulation of the Attlee Government’s nationalizations.

³⁷ Friedman speaking in *Business and Society Review*, Spring 1972; reprinted in Friedman (1975b, p. 253).

³⁸ *Free to Choose*, PBS debate 1980, Episode 3, p. 9 of transcript.

³⁹ In *Business and Society Review*, Spring 1972; reprinted in Friedman (1975b, p. 254).

But Friedman further revised his opinion in the 1970s: he observed in 1972, “I was much more optimistic in 1962 than was justified by what happened later.”⁴⁰ Friedman continued to acknowledge that the momentum for planning and nationalization had stalled, noting that “[t]here is less central planning in Britain now than in 1946,”⁴¹ but now judged that this had “diverted... growth [in government] to a different channel” (*New York Times*, August 13, 1994). Greater government influence on resource allocation, he argued, had instead been achieved via expansion of government spending (including transfer programs) and of regulation (Friedman, 1976c; Friedman and Friedman, 1998, p. 582). This changed perception was reflected in Friedman’s descriptions of the U.K. system: whereas he characterized what was launched in the United Kingdom in the 1940s as “a policy of welfare statism and central planning” (*Saturday Evening Post*, May/June 1977), Friedman argued that the system evolved into “a socialist and welfare state” (*National Review*, December 31, 1997).

CHEAP MONEY

Many countries followed “cheap money” policies in World War II and its aftermath; the U.S. case is the subject of Friedman and Schwartz (1963, Chs. 10–11). In the United Kingdom, the postwar “cheap money” policy is associated with the attempt by Chancellor of the Exchequer Hugh Dalton to break with the practice his advisor, John Maynard Keynes, had described as “the unwillingness of most monetary authorities to deal boldly in debts of long term” (Keynes, 1936, p. 207). Although announced by the Attlee Government upon its election, the long-term bond program began in earnest in October 1946, several months after Keynes’ death. Among the new government bonds created in 1946 was a series of 2.5% “irredeemable” securities, that is, securities that might be held indefinitely as a source of interest income; as Dalton noted, these new long-term securities were “often called affectionately by my name” (*Financial Times*, December 21, 1954), being unofficially known as “Daltons” or “Dalton consols” in the markets and the financial press.⁴² By issuing very low-yield medium- and long-term securities, Dalton attempted to extend the Government’s existing low interest rate policy to the entire term structure. “We have been gradually conditioning the capital market to a

⁴⁰ Friedman, October 20, 1972, remarks, in Selden (1975, p. 51).

⁴¹ In *Business and Society Review*, Spring 1972, in Friedman (1975b, p. 254).

⁴² “Dalton bonds” was also terminology that was used (see e.g., *The Times*, January 31, 1959), but apparently less frequently. In more recent years, the phrase “Dalton bonds” has taken a different usage, as most Google hits of the phrase refer to the Timothy Dalton James Bond films of the late 1980s.

long-term rate of 2½%,” Dalton observed. “... I am sure that our cheap money policy should continue to be resolutely pressed home.” (*Financial Times*, October 17, 1946.)

Bank Rate, the short-term policy rate of the Bank of England, had already been fixed at 2% in 1932; it continued there almost continuously for the rest of the 1930s and all of the 1940s. This largely paralleled the short-term interest rate policy being followed in the United States. Friedman (1982b, p. 104) criticizes the Federal Reserve for failing to outline an internally consistent explicit rationale for the U.S. cheap money policy (by implication, even a rationale that Friedman might disagree with). While this criticism may be valid for the interest-rate peg carried out in the 1930s, it is harder to make the case that the postwar cheap money policy lacked an explicit theoretical rationale, either in the United States or the United Kingdom. In both countries, the postwar continuation of the policy of cheap money seems to have been clearly motivated by Keynesian ideas, and this rationale was voiced at the official level.⁴³ Indeed, despite his complaining about the absence of an official U.S. justification for the pegging of bond prices, Friedman on many occasions described the postwar cheap money policy as arising from Keynesian theory: for example in his observation that the postwar cheap money policy was “partly under the influence of the ideas derived from Keynes.”⁴⁴

The U.K. and U.S. authorities’ particular interest in influencing *long-term* rates rested heavily on the Keynesian position that long-term rates mattered for aggregate demand much more than short rates; this interest was qualified by the consideration that, as Friedman and Schwartz (1963, p. 700) observe, even the sensitivity of demand to long-term rates was not thought to be substantial. Low long-term interest rates were also perceived as contributing to the flexibility of fiscal policy by easing the financing of the national debt. So the extension of the cheap money policy to the long-term market had both Keynesian and debt-management motivations.

⁴³ Friedman and Schwartz (1963, p. 315) attribute the initial cheap money policy in the United Kingdom to the need to refinance World War I debt. But, apparently, 1930s U.K. policymakers also justified the cheap money policy as a means of fighting unemployment (see e.g. *The Scotsman*, August 18, 1958; Johnson, 1971a, p. 49).

⁴⁴ May 25, 1959, testimony, in Joint Economic Committee, 1959a, p. 607 (p. 138 of 1964 reprint). Likewise Dacey (1947, p. 60), referring specifically to the U.K. situation, mentioned “the Keynesian analysis on which the whole cheap money policy is based.” In addition, Hallowell (1950, pp. 67–68) catalogues statements by the U.S. authorities rationalizing the cheap money policy, so Friedman’s (1982b) conjecture that the U.S. policy was not officially rationalized may need to be reconsidered.

The Dalton program of October 1946, while involving the creation of new debt instruments, was intended to drive existing longer-term securities' rates down to 2.5% too (see e.g., Hallowell, 1950, p. 41); this contrasted with the rates between 3% and 3.5% prevailing for most of the period since 1932 (Hallowell, 1950, p. 23; Robertson, 1949, p. 22).⁴⁵ Since Bank Rate was left unchanged, the experiment was not making use of the expectations theory of the term structure. On the contrary, the expectations theory would suggest that keeping the short rate unchanged tended to work against the success of a policy to reduce long-term rates. From the perspective of the *General Theory*, however, the approach made some sense: the *General Theory* saw securities as becoming equivalents of money before their yield became zero; insofar as short-term interest rates were perceived as already having hit their floor, but long-term rates had not reached their floor, the monetary authorities could carry out operations directly in long-term securities markets to encourage reductions in longer-term rates.

Wilson (1984, p. 76) observes that there were “few British economists in the 1950s and 1960s who advocated control of the money supply—Robertson, Robbins, Paish, Dacey, myself [Thomas Wilson], and one or two others...” Among those in this list who were active in the 1940s, Robertson was perhaps the leader, and is acknowledged in Friedman and Friedman (1998, p. 247) as an early distinguished skeptic regarding Keynesian economics. That skepticism is evident in Robertson's discussions of the Dalton monetary policy, as Robertson (1949, p. 22) counts himself among those “who dared to question the wisdom of this [1946] further turn of the [cheap money] screw.” A fellow critic, Dacey (1947, p. 59) wrote that “it is surprising that Mr. Dalton should have thought it good statesmanship to press rates down further at a time when inflationary forces are only kept in check with the assistance of a formidable administrative apparatus [i.e., price controls].” Among the advocates of money not in Wilson's list, financial writer Oscar Hobson deserves mention. In some respects Hobson underwent changes in thinking that paralleled those of Friedman: an initial conversion to Keynesian ideas on money in the 1930s and early 1940s, followed by disillusionment in the late 1940s and a reaffirmation of quantity-theory ideas. In this connection, Hobson wrote in 1948 of the “false doctrine of cheap money policy” (*News-Chronicle*, May 5, 1948).

⁴⁵ When serving as a discussant of Friedman's in 1970, Sir Roy Harrod paraphrased Dalton's rationale for the reduction in the long-term rate as that if “we could run a great war at 3%, we ought to be able to run the peace at 2.5%” (Harrod, 1971, p. 59).

Friedman's own later work contained critical observations on the United Kingdom's 1940s monetary framework. There are many further criticisms implicit in Friedman's descriptions of what monetary policy can and should do. Friedman's framework centered, first and foremost, on the point that "monetary policy is not about interest rates; monetary policy is about the rate of growth of the quantity of money."⁴⁶ The Fisher relation provided the only enduring channel by which the central bank could affect interest rates, be they short- or long-term. Monetary policy could exert other, more transitory influences on interest rates, but Friedman was skeptical that these influences justified central banks' claims that they could control long-term interest rates (see e.g., Friedman and Schwartz, 1963, p. 514). Certainly, he believed that a base money injection could produce some temporary downward pressure on long-term rates, both via the standard expectations channel (i.e., via the liquidity effect on current and expected future short rates) and via a portfolio effect on the long-short spread or term premium (see e.g., his June 1966 memorandum to the Board of Governors, published in Friedman, 1968a, p. 156). But for the central bank to exploit these effects in a way that made the long-term interest rate a policy instrument would require being able to overwhelm the "nonmonetary forces affecting interest rates"⁴⁷ as well as the Fisher effect, which showed up in "long-term interest rates much sooner"⁴⁸ than in short-term rates, and worked in the opposite direction of the liquidity and portfolio effects of the money injection. Moreover, Friedman noted, the sustainability of this policy was doubtful, since for a central bank to "peg a particular interest rate... it must accept whatever happens to other magnitudes affected by the [monetary] base, including the level of inflation" (*Wall Street Journal*, April 5, 1990).

The Dalton attempt to bring down long-term rates had the temporary appearance of success. Rates on existing long-term securities fell toward the new 2.5% baseline. For example, Friedman and Schwartz's (1982, Table 4.9, p. 133) data on "old" consols (i.e., the perpetual-horizon security already being traded before the release of the new, "Dalton" consols) shows an average rate of 2.92% in 1945 and 2.6% in 1946. But the effort to hold down long-term interest rates did prove unsustainable, and in the course of 1947 long-term rates rebounded; Friedman and Schwartz's series shows an average for 1947 of 2.76%, rising to 3.21% in 1948. Friedman (1970a, p. 8) observed, "Chancellor

⁴⁶ From Friedman's appearance on *Meet the Press*, October 24, 1976.

⁴⁷ From Friedman's October 1965 memorandum to the Board of Governors, published in Friedman (1968a, p. 136).

⁴⁸ Friedman (1983a, p. 11).

Dalton tried to follow the Keynesian policy of keeping interest rates very low. As you all know, he was unable to do so and had to give up.” A few months after Dalton left office, the *Financial Times* reported, “The attempt to hold the rate of interest on government long-term borrowing at 2½% has now been officially abandoned.” (*Financial Times*, January 3, 1948.)

The pressure on the cheap money policy in the United Kingdom was more acute than in the United States, because the associated pressure on aggregate demand was one-sided. An interest-rate peg can in principle be contractionary in effect, as when the central bank has to withdraw base money to enforce the peg. Friedman and Schwartz (1963, p. 596) find that the U.S. cheap money indeed produced deflationary pressure over 1948, and Friedman and Schwartz (1982, p. 76) classify 1948–49 as a business contraction in the United States. No corresponding contractionary episode is evident during the U.K. postwar cheap money period, and Friedman and Schwartz (1982, p. 76) classify 1946–51 as a continuous expansion in the United Kingdom. The U.K. experience consequently corresponded more literally than did the U.S. case to Friedman’s summary statement that “the stock of money rose as a result of the cheap-money policies and so did prices, either openly or in whatever disguise...”⁴⁹

The Dalton policy on long-term interest rates was the first element of the U.K. monetary framework to break under this one-sided pressure; the exchange rate policy was next, with sterling devaluation taking place in 1949. The breakout of the Korean War in 1950 magnified the pressure on the remaining component of the cheap money policy, namely the holding of Bank Rate at 2%. The *Financial Times* noted (February 10, 1951): “Both the British and American governments seem determined not to use higher interest rates to combat inflation.” This determination contrasted with Friedman’s position, which he articulated in 1952 as follows: “The purpose of monetary policy is to maintain price stability, and on some occasions this will call for actions that tend to raise interest rates...”⁵⁰ Bank Rate was finally raised by the newly elected Churchill Government in November 1951—one of very few economic actions of Churchill which Friedman applauded. “No country succeeded in stemming inflation without adopting measures that made it possible to restrain the growth in the stock of money,” Friedman observed at the

⁴⁹ May 25, 1959, testimony, in Joint Economic Committee (1959a, p. 607; p. 138 of 1964 reprint).

⁵⁰ March 25, 1952, testimony, in Joint Committee on the Economic Report (1952, p. 736).

end of the 1950s. “And every country that did hold down the growth in the stock of money succeeded in checking the price rise.”⁵¹

PERSONALITIES, 1938–1946

JOHN MAYNARD KEYNES

Though Friedman and Keynes never met, they corresponded on two occasions, in 1935 and 1938. Both occasions were in connection with Friedman’s submission of papers for consideration by the *Economic Journal*, of which Keynes was Editor. The first attempt, which resulted in Keynes rejecting the paper, is described in Friedman and Friedman (1998, pp. 52–53). In 1938, Friedman tried again, with a submission entitled “The Assumptions of Linearity and Normality in the Analysis of Family Expenditure Data.” His submission letter, dated February 4, 1938, began “Dear Mr. Keynes” (Keynes would not be Lord Keynes until 1942), and carried the NBER letterhead. Friedman mentioned that the submission had been rejected by another journal on the grounds that its results were incorrect, but that “[n]eedless to say,” he did not agree with this conclusion.⁵² (“Needless to say” would become a stock phrase in Friedman’s writings.)

Keynes proceeded to draft a rejection letter and to send this draft to one of the authors whom Friedman’s paper had criticized, Arthur Bowley, as well as a copy of the actual article submission “sent me by Mr. Friedman.”⁵³ Bowley responded with several criticisms of the submission, to the effect that Friedman (whom Bowley called “Friedmann” throughout his letter) made no substantive contribution to economic theory, made *a priori* claims that needed to be demonstrated statistically, and reflected in his work too great an attachment to the statistical approaches of Sir Ronald Fisher.

Friedman’s latter-day adversary David Hendry has noted that empirical work is vulnerable to easy rejection by journals on the basis either that the results are obvious, or that they are incorrect.⁵⁴ Friedman’s submission was at one point in danger of both types of rejection: Keynes’ draft rejection stated that, while the previous journal had rejected

⁵¹ May 25, 1959, testimony, in Joint Economic Committee (1959a, p. 607; p. 138 of 1964 reprint).

⁵² Keynes papers (*Economic Journal* correspondence, Friedman folder), Kings College, Cambridge University.

⁵³ The Keynes-Bowley exchange on Friedman is discussed briefly in Moggridge (1990, pp. 155, 156) and is held in the Bowley folder of the *Economic Journal* correspondence in the Keynes papers.

⁵⁴ Hendry (1993, p. 115).

the paper on the grounds that it was incorrect, the *Economic Journal* was rejecting it on the basis that Friedman's results were too obvious. But, after receiving Bowley's letter, Keynes rewrote his rejection letter and made it more conciliatory. Keynes' revised letter of rejection, dated March 30, 1938, did contain a very condensed version of Bowley's criticisms, but gave the basis for rejection as that the paper's content was mainly statistical, not economic.⁵⁵ It was a critique that Friedman evidently took to heart, as he would later criticize others' work for sacrificing economic substance in favor of mathematical or statistical material. The form of words in Keynes' rejection—that Friedman should develop his research closer to the “strictly economic sphere”⁵⁶—also must have made an impression, as Friedman used the similar phrase “economic sphere proper” in *Free to Choose* more than 40 years later.⁵⁷

GEORGE ORWELL

“I'm sure you all remember that great book *1984*,” Friedman observed in the late 1970s, “and unfortunately we're getting all too close both to the date and the reality.” (*San Francisco Chronicle*, January 30, 1979.) This reference was one of many Friedman made to the writings of George Orwell. From the early 1970s, Friedman frequently drew parallels between the expanded role of government and the role of the state in Orwell's novels. Friedman referred to government as “Big Brother” in a *New York Times* article (October 29, 1971) and continued to do so in at least nine *Newsweek* columns over 1972–1979.⁵⁸ He accused U.S. government publications of using “Orwellian doublethink” in the language they used to promote government programs,⁵⁹ and also had

⁵⁵ The relevant passage from Keynes' letter is quoted in Shepherd (1994, p. 28). The letter itself is in the Keynes papers (*Economic Journal* correspondence, Friedman folder), Kings College, Cambridge.

⁵⁶ March 30, 1938, letter, Keynes papers (*Economic Journal* correspondence, Friedman folder), Kings College, Cambridge.

⁵⁷ Friedman and Friedman (1980, p. 51 of the scanned U.S. edition available on google books).

⁵⁸ For example, in his July 4, 1977 *Newsweek* column, Friedman wrote, “Government has become Big Brother.” Before the 1970s, the British novel Friedman had invoked in his discussions of government's growth had been Mary Shelley's *Frankenstein*. In *Capitalism and Freedom*, Friedman had said, “How can we keep the government we create from becoming a Frankenstein that will destroy the very freedom we establish it to protect?” (Friedman, 1962a, p. 2.) He renewed this analogy in a 1975 *Newsweek* column in which he said “big government is really Frankenstein” (*Newsweek*, December 29, 1975); in October 20, 1975 Congressional testimony (Joint Economic Committee, 1976, p. 48); in *Milton Friedman Speaks*, Episode 13 (p. 34 of transcript); and in a December 1979 conference at the Hoover Institution, Stanford University (see Anderson, 1982, p. 184). In the 1980s, Friedman changed—i.e., belatedly corrected—the analogy to one between government and Frankenstein's monster (*Newsweek*, August 10, 1981; Friedman and Friedman, 1984, p. 45 of U.S. edition).

⁵⁹ *Newsweek*, June 14, 1971; also Cohen and Friedman (1972, p. 230) and Friedman and Friedman (1980, p. 134 of U.K. paperback edition).

occasion to refer to “Newspeak” (*San Francisco Chronicle*, January 30, 1979), “Orwellian language”⁶⁰ and “Orwellian terms.”⁶¹ A 1978 Friedman talk mentioned Orwell’s *Animal Farm*.⁶² In 1980, the book version of *Free to Choose* featured bibliographical citations of both *Animal Farm* and *1984*.⁶³

In the 1940s, one commentator taking a notably less apocalyptic view of the expansion in the role of government was George Orwell. Writing in the *Manchester Evening News* in early 1946, Orwell portrayed the expansion of the role of government being undertaken in the United Kingdom in most-un-1984-like terms. “During recent years it has become more and more obvious that old-style, *laissez-faire* capitalism is finished,” Orwell began. He clearly approved this development, arguing that the flaws of capitalism had been “grasped by various clear-sighted individuals” decades before, and the “events of the last six years have merely underlined the lesson. Unmistakably, the drift everywhere is towards planned economies and away from an individualistic society in which property rights are absolute and money-making is the chief incentive.” Orwell went on to comment critically on Friedrich Hayek’s *Road to Serfdom* (Hayek, 1944). As well as criticizing the substance of the book, Orwell downplayed its impact in the United Kingdom. So whereas Friedman later said that Hayek’s book was a “bestseller in Britain and the U.S. in 1944 and 1945” (*Forbes*, December 12, 1988) and that “both in Britain and the United States, it created something of a sensation” (CSPAN, November 20, 1994), Orwell merely said that the book had “raised a great deal of discussion, particularly in the United States.” Orwell concluded that Hayek’s work was “wasted labor” (*Manchester Evening News*, January 24, 1946).

After Friedman became prominent, the economics literature would generate arguments about whether economic policies and economists’ positions had developed into being “more Friedmanite than Friedman” (Higgins, 1981, p. 127) or “more Friedmanian than Friedman” (Patinkin, 1986, p. 120). Likewise, when discussing the practical impact of the increased role of government, Friedman seems to have been more Orwellian in his perspective than was Orwell.

⁶⁰ Friedman (1976d), reprinted in Friedman (1983b, p. 70); Friedman also used the term in Anderson (1982, p. 181).

⁶¹ Friedman and Friedman (1980, p. 134 of U.K. paperback edition).

⁶² *Milton Friedman Speaks*, Episode 14, p. 12 of transcript.

⁶³ Friedman and Friedman (1980, pp. 134–135 of U.K. paperback edition).

WINSTON CHURCHILL

In April 1949, London's *Strand* magazine took out an advertisement for its latest issue in the *Financial Times*. The advertisement focused entirely on Winston Churchill. "The Churchill legend is universal," the advertisement text related. "Wherever English men and women get together, they tell stories of the classic sayings and memorable doings of one of the greatest and wittiest men in history." The *Strand* announced that its latest issue was devoted to a compendium of stories about Churchill. (*Financial Times*, April 1, 1949.) The fact that a major magazine was giving blanket coverage to someone who had been overwhelmingly defeated at the polls four years earlier, brought out the formidable reelection problems facing the Attlee Government.

Friedman's assessment of Churchill agreed with the *Strand's* as far as his role in history was concerned: "Winston Churchill was certainly one of the greatest men of our century or any century." But Friedman had a crucial reservation: Churchill's "economic decisions were notoriously bad." (*Newsweek*, March 31, 1975.) The familiar example that Friedman cited as Churchill's "most tragic" decision (*Newsweek*, March 31, 1975), as well as one that succumbed to "prevailing financial opinion" (Friedman, 1974a, p. 325), was that, as Chancellor of the Exchequer, to return the United Kingdom to the gold standard at its historical, but unrealistically strong, exchange value. Friedman also felt Churchill deserved his share of the blame for the outcome that in the early twentieth century, "after *laissez faire* delivered everything it had promised[,] England started its slide toward socialism."⁶⁴ Specifically, Friedman cited the early welfare state measures Churchill introduced as a Cabinet member in the first decade of the 1900s,⁶⁵ which formed part of the "small beginnings" of "a major increase in the role of the state" (*Newsweek*, November 10, 1980). Friedman came to the conclusion that Churchill had "no feel whatsoever for economics" (*Jerusalem Post*, November 6, 1987) and "came a cropper every time he had occasion to get involved" (Friedman, 1981, p. xvi).

Aware of the continuing political challenge posed by Churchill's wartime legend, Prime Minister Attlee concentrated his fire exactly where Friedman would: on economics. "I remember very well when Mr. Churchill was Chancellor of the Exchequer—the most disastrous Chancellor of this century," Attlee told an audience of supporters in 1947. "It

⁶⁴ Friedman, October 20, 1972, remarks, in Selden (1975, p. 51).

⁶⁵ Friedman and Friedman (1980, p. 99 of U.S. scanned edition on google books).

was he who brought us back on the Gold Standard... Much of our trouble today can be traced back to that error of ignorance and to his simple trust of others in a field where he had little knowledge.” (*News-Chronicle*, April 26, 1947.)

Churchill clearly attempted to compensate for his weakness on economics by making allusions to his World War II speeches and successes in his proclamations on economic policy. For example, in a 1949 speech on the Government’s nationalization programs, Churchill said, “Never before in the history of human government has such great havoc been wrought by such small men.” (*News-Chronicle*, July 25, 1949.) And, in 1951, more provocatively: “Six years of Socialist Government have hit us harder in our finance and economics than Hitler was able to do.” (*Financial Times*, July 23, 1951.)

Attlee contended that “the strength of Mr. Churchill’s language is in inverse ratio to his knowledge of the subjects.” But he acknowledged that all of Churchill’s statements, including those on economics, received great attention. “It is unfortunate that his words are taken at face value in other countries; they don’t realize it’s just Winnie’s way.” (*News-Chronicle*, July 25, 1949.)

Churchill’s speeches while Leader of the Opposition seemed to promise a major winding back of the extensions of the government’s role undertaken under Attlee. For example, Churchill stated in 1949 that, “if Socialism is a fallacy, its most direct expression, nationalization, is a failure.” (*News-Chronicle*, July 25, 1949.) In fact, the Conservative Party had already agreed in principle not to reverse Labour’s chief 1940s industrial nationalizations, and the only major nationalization that the Conservatives went on to reverse was that of the steel industry, which was not nationalized until 1951.

In a 1979 article, the U.S. columnist George Will quoted a 1940s statement by Churchill that the Attlee Government’s nationalization of the Bank of England in 1946 did not “raise any matter of principle.” (*Baltimore Sun*, February 11, 1979.) In providing the quotation, Will presumably intended to signify that Churchill’s acquiescence to Bank of England nationalization was another abandonment of free-market principles. But in so doing, Will revealed a misunderstanding of the role of the central bank.⁶⁶ Friedman would not have sympathized with Will’s point; for the United States, Friedman observed

⁶⁶ Dell (2000, p. 503) makes a similar error in discussing the Thatcher privatizations of the 1980s, erroneously suggesting that it was ironic that the Bank of England was not among the entities privatized.

that “[i]t is a mistake to think of the Federal Reserve as not part of the government.”⁶⁷ The same point held for the Bank of England, whatever the formalities of ownership. Nationalization of the Bank of England was a breed apart from the industrial nationalizations taking place over the same period. By the time formal nationalization of the Bank took place, private ownership did not make a difference to the issue of central bank independence. Monetary policy decisions were already made by the Treasury: in 1937 it was noted of the Bank, “[t]hough privately owned, it is substantially under public control” (*News-Chronicle*, November 18, 1937), and the *Financial Times* observed in 1946 that that the Treasury had “for many years effectively controlled the Bank’s policy” (*Financial Times*, March 1, 1946).

In any event, Friedman was in no position to be critical of the formal carrying out of the nationalization of the central bank. Particularly in the 1940s and 1950s, he was a zealous advocate of a reform proposal, somewhat nondescriptively referred to as the “Chicago plan” or “100 per cent money,” of 100 percent mandatory reserve requirements, which amounted to the *de facto* nationalization of the depository activities of the entire *commercial* banking system.⁶⁸

The day after the 1951 election, the front page of the *Financial Times* announced, “MR. CHURCHILL PRIME MINISTER AGAIN” (*Financial Times*, October 27, 1951). Churchill had lost the popular vote to Attlee for the third election in a row, but had this time won enough seats to form a government. In February 1954, the London *News-Chronicle* published a Gallup poll which, the newspaper related, “shows that a majority in Britain now has come to the conclusion that Sir Winston Churchill is too old to be Prime Minister, and should retire.” (*News-Chronicle*, February 1, 1954.) Around this time, Friedman undertook a firsthand investigation of the issue by watching Churchill in the

⁶⁷ January 22, 1976, testimony, in Committee on Banking, Currency, and Housing (1976, p. 2188).

⁶⁸ I realize of course that this scheme would leave the equity capital of the banks in private hands, and so would not correspond to formal bank nationalization. But Friedman was the first to acknowledge that effective nationalization of an industry did not require literal government takeover of that industry’s equity capital; that “stringent controls” could mean “the equivalent of nationalization” (*The Listener*, April 27, 1978). A 100% reserve requirement scheme, as spelled out in Friedman (1960), would mean that commercial banks’ deposit-taking function would be effectively absorbed into the government sector, with deposits made with any commercial bank routed immediately and in full to the central bank, and invested exclusively in government securities. As Friedman admitted, such a reform would make the commercial banks branches of the Federal Reserve System in many respects. Holding of equity capital, no longer being a stake with which to exert managerial control over the bank’s overall investment and expansion decisions, would mainly mean influence over policies on how to expand the nondeposit liabilities of the bank, and what loans and investments to make with those liabilities.

House of Commons. Friedman wrote to Anna Schwartz that Churchill “looked every bit of his age,” but that he seemed mentally secure, refuting rumors that Churchill had lost his mind (Friedman and Friedman, 1998, p. 251). Churchill finally stepped down as Prime Minister in April 1955. Among Churchill’s actions (or inaction) in his 1951–55 government that added to Friedman’s low opinion of his management of peacetime affairs were Churchill’s squelching of a plan to float the pound, his preservation of most of the Attlee nationalizations, and his continuation of conscription (universal national service) into peacetime. In 1987, Friedman summed up: “Winston Churchill was clearly a great man, but every time he touched an economic issue, he came down on the wrong side—from 1908 till he left office.” (*Jerusalem Post*, November 6, 1987.)

3. 1946–1959

EVENTS, 1946–1959

From 1948 to 1954, Friedman made a series of visits to the United Kingdom and to Continental Europe: a 1948 journey to Switzerland, the United Kingdom and France; a 1950 assignment to France with visits to other parts of Europe; a 1952 trip to the United Kingdom to give two guest lectures at the London School of Economics; and a year at Cambridge University as a visiting professor in 1953–54. This degree of travel was unusual by the standards of the time. Anna Schwartz, for example, did not travel outside North America until the 1970s. But it was not a prospect Friedman relished. He had little interest in travel *per se*, regarding vacations as providing negative utility by themselves, compensated by the positive utility derived from boring friends afterwards with slides of the trips (see Friedman, 1969a, p. 49). Visits to art galleries or the opera were a waste of his time, and Friedman treated with disdain suggestions that he should spend any of his time in Europe on them.

At the same time, Friedman held the United Kingdom in high regard, considering himself “a person who has benefited enormously from the British heritage” (BBC2, November 9, 1976). Using formulations that would horrify American exceptionalists, Friedman argued that “Britain is the cradle of our freedom and of our democracy” (BBC2, November 9, 1976) and “the source of our freedom, constitution, and Declaration of Independence.”⁶⁹ He also acknowledged the contribution of U.K. economic thought on

⁶⁹ April 16, 1996, talk at Claremont College, broadcast on CSPAN on December 26, 1996.

many occasions; “economics owes so much to the work that has been done on this island,” he observed in 1970 (Friedman, 1970a, p. 1); in 1953, Friedman referred to the United Kingdom as “the land of Adam Smith and David Ricardo” (*The Economist*, January 3, 1953); and in 1984 he listed these two along with Mill, Marshall, Jevons, and Keynes, among the great economists of all time (in Friedman, 1985, p. 12). In monetary analysis specifically, Friedman (1953a, p. 42) credited David Hume with the “basic core” of monetary theory; and he went further in the 1980s, as we will see, naming Hume as the originator of monetarism.

Friedman’s first visit to the United Kingdom in 1948, consisting of “two or three days in England, in London,”⁷⁰ left him convinced that it was being “economically strangled by the law obedience of her citizens” (Friedman, 1962b). Friedman was persuaded by the argument made by George Stigler, with whom he made the trip, that price controls were distorting the U.K. to an extent that they were not in France, because of the more extensive French underground economy.⁷¹ Price controls had been introduced by the United Kingdom in wartime, Friedman later observed, in an “attempt to suppress the inflation arising from wartime spending, financed largely by increasing the money supply” (*Newsweek*, November 27, 1972). The Attlee Government continued the controls into peacetime. Friedman opposed price controls both as a wartime and a peacetime measure (see his October 6, 1969, testimony in Joint Economic Committee, 1970a, pp. 815–816). The peacetime controls in the United Kingdom and on the Continent were, he argued in an early intervention, impeding Europe’s economic recovery (*New York Times*, January 11, 1948).

Other damaging restrictions, Friedman contended, came in the “foreign exchange controls that strangled Western Europe after the war.”⁷² Foreign exchange controls were not initially emphasized by Friedman in the 1940s, when his focus was on price control. “I wrote my first article [on exchange controls] in 1950,” Friedman later recalled, “when I was in France in connection with the Common Market arrangements.” (*Jerusalem Post*, November 6, 1987.) For the United Kingdom, Friedman’s position, maintained from the early 1950s, was that exchange controls had such a depressing effect on the level of the pound sterling that if the U.K. authorities floated the pound and maintained exchange controls, the pound would tend to depreciate, whereas if they floated simultaneously with

⁷⁰ *Milton Friedman Speaks*, Episode 1, p. 9 of transcript.

⁷¹ Friedman (1962b); and *Milton Friedman Speaks*, Episode 1, p. 9 of transcript.

⁷² Friedman (1964b); p. 78 of 1969 reprint.

the removal of exchange controls, the pound would appreciate (Friedman, 1953b; Friedman and Schwartz, 1982, pp. 290–294). This conjecture was borne out when the pound appreciated after the abolition of exchange controls in 1979. Friedman criticized the exchange controls on economic grounds, but “entirely aside” from their economic aspects, he opposed them on grounds of “human freedom.”⁷³ It violated the “free market in ideas,” he said in 1977, “if a country, as Great Britain did immediately after the war, has exchange controls under which no citizen of Britain may buy a foreign book unless he got authorization from the Bank of England.”⁷⁴

Even by the early 1950s, the United Kingdom had acquired a basket-case image in the United States for its postwar performance, with extensive economic aid by the United States to the United Kingdom highlighting the problem. “When people say, ‘Well, American aid bailed Germany out,’ I add that American aid also bailed Britain out,” Friedman later observed. “The amount we gave to Britain in the British-American loan was far greater than anything Germany got.” (*Saturday Evening Post*, May/June 1977.) Comedian Bob Hope (who would go on in 1983 to serve on a committee for a dinner in Friedman’s honor)⁷⁵ caused a stir in the British press in the early 1950s for including in his routine a remark that before his next meeting with Winston Churchill, President Eisenhower would have to have his pockets sealed to prevent being pick-pocketed (*Daily Express*, March 23, 1953).

The United Kingdom was also a recipient of aid from the United States via the Marshall Plan. Friedman contended that “Europe would have recovered with or without the Marshall Plan,” and opposed the Plan at the time and in retrospect (Friedman, 1982a, pp. 32–33). He argued that the “Marshall Plan and similar programs” of the U.S. government had “been harmful to the rest of the world”⁷⁶ because government-to-government economic aid strengthened the government sector at the expense of the private sector.⁷⁷ It was, nevertheless, as an advisor to the Marshall Plan that Friedman made a second visit to Europe, in late 1950, basing himself in Paris (Friedman, 1992, p. 248; Friedman and Friedman, 1998, Chapter 12).

⁷³ *Free to Choose* BBC2 debate, March 22, 1980, p. 21 of transcript.

⁷⁴ *Milton Friedman Speaks*, Episode 3, p. 16 of transcript.

⁷⁵ See Friedman (1984a, p. 8).

⁷⁶ September 23, 1971, testimony, in Joint Economic Committee (1971, p. 722).

⁷⁷ For Friedman’s elaborations of this argument, see Friedman (1958a, 1958b); *Newsweek*, December 21, 1970; and *Newsweek*, November 14, 1983.

“Plans to spend a quarter at the London School [of Economics] in the spring of 1952 fell through,” Friedman recalled in 1994, “but did lead to my making a three-week trip to Britain and France, giving two lectures at the London School of Economics...”⁷⁸ Friedman’s talk “Classical Counter-Revolution and Monetary Theory and Policy,” at the London School of Economics in May 1952, opened with a major gaffe—or a clanger, to use the U.K. nomenclature. His speaking notes state, “With some hesitancy the American speaks on this topic to an English audience. Basic contributions all English. Classical—Hume, Ricardo, Thornton, Marshall; ...”⁷⁹ The problem, of course, was that David Hume was Scottish, not English. Indeed, the two British economists with whom Friedman identified most and whom he would most often quote in his writings, Hume and Adam Smith, were Scottish. (During his career Friedman would have less wholehearted agreement with two more contemporary Scottish figures in economics, Alec Cairncross and David Hendry.) To judge by Friedman’s later statements, he learned his lesson, and became more careful about distinguishing the Scottish from the English. In arguing against the Bretton Woods system during Congressional testimony in 1963, Friedman noted that what mattered to the U.K. consumer was a good’s U.K. price, not the same price expressed in U.S. dollars; different dollar values of the price were “all the same to an Englishman—or even a Scotsman.”⁸⁰

Around the time of Friedman’s 1952 visit, the U.K. unemployment rate averaged 2.1%; in 1951 it was only 1.2%, and in 1953 the average was 1.8%.⁸¹ These were lower rates than prevailing in the United States, but Friedman later cautioned against interpreting such low rates as a badge of honor. In his Nobel lecture, Friedman cited the United Kingdom in the 1950s as an example of a country with an inefficiently low unemployment rate, reflecting the fact that a “highly static rigid economy may have a fixed place for everyone” (Friedman, 1977a, p. 459). “Progress depends—it sounds funny, but it’s true—on unemployment,” Friedman elaborated in 2004. “...Because that’s the only way you can provide the necessary labor force for the new development, the new industries that are coming along.” (*Investor’s Business Daily*, April 15, 2004.) The U.K. economy in the 1950s not only featured an inefficiently low unemployment rate, but a tendency for aggregate demand to be expanded too rapidly, forcing unemployment temporarily below its low natural value and creating inflationary pressure.

⁷⁸ From Friedman’s notes “1952 MF trip,” in a 1994 letter to Anna Schwartz; courtesy Anna Schwartz.

⁷⁹ May 1952 lecture notes by Friedman; courtesy Anna Schwartz.

⁸⁰ November 14, 1963, testimony, in Joint Economic Committee (1963, p. 454).

⁸¹ London and Cambridge Economic Service (1963, Table F, p. 11).

Since U.K. policymakers were aware by the late 1940s of the distinction between full and overfull employment, the question arises why they kept overdoing expansion. Some of the overheating in the late 1940s and the 1950s might be attributed to preemptive stimulus in anticipation of a collapse in private demand. Friedman (1973a, p. 5) noted that while “a great post-war depression... was widely predicted,” it “kept being expected but it never occurred.” This observation was true of the United Kingdom, with Chancellor Dalton stating in 1945 that the “government must arm itself with anti-slump powers, so that never again, as in past years, shall prices, productivity, and employment all fall away through the failure of private enterprise” (*Financial Times*, November 23, 1945). In particular, “secular stagnation,” due to drying up of private investment opportunities and to excessive consumer saving, was feared in the 1940s and cited as a reason for government stepping in with its own demand for output. Friedman was an early critic of the secular stagnation thesis (Friedman, 1948, p. 262), and the criticism had become widespread by the 1950s as the prospect of a consumption collapse dwindled. In fact, the secular stagnation theory was one aspect of Keynes’ thinking that was widely rejected in the United Kingdom even in the Keynesian 1950s; the *Financial Times*, for example, referred to “Keynes’ one-sided fear of over-saving” (May 23, 1955) and to “Keynes’ incredibly shortsighted forecast of declining investment opportunities” (October 15, 1956). But precisely because the relevance of the secular stagnation hypothesis was in so much doubt by the 1950s, it is hard to cite belief in it as the reason for continued U.K. over-expansion in that decade.

Another possibility is that 1950s policymakers underestimated the natural rate of unemployment. It is true that unemployment rates associated with full employment, initially set at 3%, were revised down by policymakers once rates of 1–2% seemed achievable. Commentators such as Oscar Hobson called for an upward revision of the estimate of the full-employment unemployment rate (*Financial Times*, August 22, 1955). But the phenomenon of *sustained* below-2% unemployment in the United Kingdom in the 1950s suggests that the natural rate in the 1950s was not actually far from 2%, and Friedman’s Nobel lecture presumed, as noted above, that the U.K. natural unemployment rate was indeed low during the 1950s, even though not as low as some of the rates actually achieved. Official underestimation of the natural rate is also unlikely to account for the piping-hot economic conditions of 1955, since the U.K. authorities knew the economy was overheated in that year; they were finding that they were generating more demand than intended, and were therefore trying to rein in demand.

The failure to deliver the right dosage of demand during the 1950s seems most attributable to the U.K. government's misguided view of how to affect demand. Here, fiscal policy—or as Friedman somewhat redundantly referred to it on occasion, “government fiscal policy”⁸²—received pride of place, reflected in Chancellor of the Exchequer Peter Thorneycroft's observation in 1957, “The big instrument of government policy in all these matters is the budget.” (*Daily Express*, July 13, 1957.) This contrasts with Friedman's position on fiscal policy which, of course, was: “In my opinion, a budget deficit is ‘expansionary’ only if it is financed by printing money.” (*Newsweek*, February 15, 1971.) According to this interpretation, any apparent connection between fiscal actions and aggregate demand was not an indication of the working of the Keynesian multiplier process, but was instead a by-product (a “disguised reflection” in the terminology of Friedman and Meiselman, 1963) of the fact that deficits in practice were monetized.

Figure 3 plots the ratio of the U.K. budget balance to nominal GDP, and the growth rate of the U.K. monetary base. The budgetary series is one available for 1948–1999, now discontinued but formerly reported as line 80 in hard copies of the IMF's *International Financial Statistics*. Nominal GDP is the annual average series for the United Kingdom from Haver-IFS (downloaded March 2009). The monetary base series is the annual average of a series obtained by splicing annual averages of the Capie-Webber (1985) into the Bank of England break-adjusted base money series. The plotted growth rate of the base closely resembles that depicted in Benati (2005, Chart 1), which was based on similar sources; in addition, for 1948–71, the growth rates resemble those of the high-powered money series in Friedman and Schwartz (1982, pp. 125–126). Base growth is

⁸² Friedman used “government fiscal policy” in his *Encyclopedia of the Social Sciences* entry on the quantity theory of money (Friedman, 1968c, p. 438). As befits an adherent of the quantity theory of money, which builds on—but, as Friedman frequently stressed, does not consist solely of—a tautology (viz., the equation of exchange), Friedman occasionally veered toward tautology in his statements. His use of “statistical regressions” (e.g. Friedman, 1977b, p. 410; Friedman and Schwartz, 1982, p. 217) might be defended as a means of distinguishing the use of “regression” from its meaning as the opposite of progression; his use of “total aggregate demand” (*Sunday Times*, September 20, 1970) could be excused as an attempt to distinguish overall demand from private aggregate demand; while his reference to an “exponential growth trend” (Friedman, 1957a, p. 146) might, perhaps, be an attempt at differentiation from an exponential declining trend. Harder to defend are Friedman's use of the terms “mathematical equations” (Friedman, 1957a, p. 152) and “temporary pause” (*Meet the Press*, October 24, 1976), and his fondness for the phrase “identically the same” (e.g., in Friedman, 1957a, p. 212; Cohen and Friedman, 1972, p. 25; *Milton Friedman Speaks*, Episode 8, p. 24 of transcript; and twice in Friedman, 1984b, p. 42). In a league of their own, however, are two statements Friedman made in early 1977: “Franco referred, in his verbal talk...” (Friedman, 1977c, p. 14.) “I'm not suggesting that we retroactively go back...” (On *Dinah!* (Dinah Shore television program), March 30, 1977; quoted in *Fresno Bee*, May 29, 1977.)

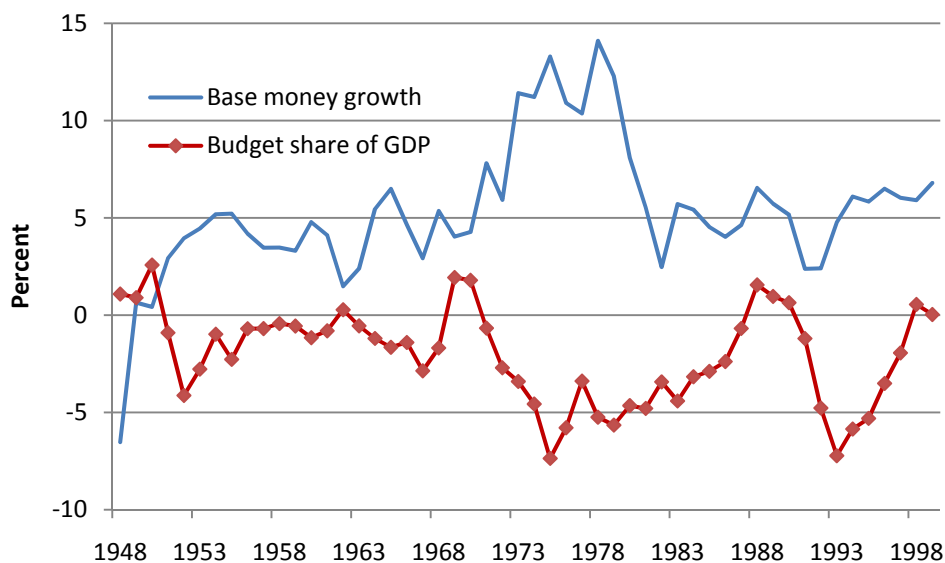


Figure 3. U.K. budget-balance share of GDP vs. monetary base growth, annual data, 1948–1999

highly correlated with the budget-balance share for 1948–79 (correlation = -0.80) while the correlation for 1980–99 is negligible (correlation = 0.08). The association between base growth and deficits supports Friedman’s contention that in the early postwar decades U.K. government deficits were monetized,⁸³ so that the period simply does not provide clean evidence of the effects of “pure” fiscal policy. Attempts to quantify a multiplier impact of deficits and surpluses without attempting to hold constant the reaction of the monetary authorities simply beg the question.

It may seem perplexing that my discussion of demand policies in the United Kingdom in the 1950s has been able to proceed so far without a discussion of the fact that the pound sterling was on a fixed exchange rate. I have occasionally seen it argued that the U.K. authorities did not actually pursue Keynesian policies before the 1970s because they were constrained by their Bretton Woods obligations.⁸⁴ This argument overlooks the extent to which foreign exchange controls reduced the impact of the exchange rate constraint on the formation of demand management policy. As Friedman and Schwartz (1963, p. 105) observe in discussing the postwar United Kingdom, “the development of direct exchange and trade controls gave it means of affecting its balance of payments other than through movements in prices and incomes”; relatedly, exchange controls gave the U.K.

⁸³ Friedman (1975c, pp. 72–73) argues that fiscal deficits were stimulative in Western countries in the postwar period (up to that point) because they were in practice monetized.

⁸⁴ This argument was used, for example, by R.J. Ball in the *Financial Times*, February 4, 1981.

authorities some room to separate fixing the exchange rate from setting interest rates. There was no occasion in the 1950s when there was a Bank Rate increase that could not be justified by domestic conditions; reflecting this, the Bank of England Governor testified in 1958 that foreign exchange market considerations had determined the timing (in terms of the specific week) of Bank Rate moves, but not the actual moves themselves, which were invariably also shaped by internal considerations.⁸⁵ Bretton Woods did not override what the *Financial Times* (December 21, 1953) called the “modern principle of shaping policy by reference to domestic monetary needs.” The coexistence of substantial monetary policy independence and a fixed exchange rate explains why, during the 1950s and 1960s, Lionel Robbins simultaneously criticized the idea of floating rates and advocated that the U.K. monetary authorities manipulate the monetary base to achieve price stability. As Friedman (1978a) later pointed out, a *bona fide* conflict between the exchange rate and domestic considerations in the Bretton Woods system led typically to the exchange rate giving way, as it did in the United Kingdom in 1949, 1967, and 1972.

As discussed below, by the time Friedman spent 1953–54 in the United Kingdom, the development of Friedman’s monetarism was well advanced, to the point where, in reprinting his (1942) essay on inflation, he added material on money, attributing its previous absence to the “prevailing Keynesian temper” of the 1940s (Friedman, 1953a, p. 253). Samuel Brittan, who became an undergraduate student during Friedman’s stay at Cambridge, reports that Friedman, while already a monetarist, was better known at this point as an advocate of a floating exchange rate (Brittan, 2005, p. 294). Friedman had had a letter published in *The Economist* (January 3, 1953) advocating that sterling be floated.

Friedman’s views on money did not endear him to many of the members of Cambridge University’s Economics Department, and their reaction was largely to act as a Keynesian closed shop, excluding Friedman from activities, though Friedman and Friedman (1998, p. 247) mention Nicholas Kaldor—one of the most acerbic of Friedman’s later critics—as someone who treated them well. Also in the department was the force of nature known as Joan Robinson. Alvin Marty, who managed to get along well with both Friedman and Robinson, recalled that “Mrs. R. disliked Americans, American foreign policy, and ‘American’ economists.”⁸⁶ Friedman’s views deviated on several issues from most

⁸⁵ See the answers by Bank of England Governor Cobbold, in Radcliffe Committee (1960a, pp. 137, 155).

⁸⁶ Marty (1991, p. 6).

American economists, but in directions which would make him even less acceptable to Robinson. Robinson would view the attention subsequently given to Friedman's positions on monetary policy with disapproval and cynicism. In a June 1978 comment published posthumously in Kahn (1984, p. 204), Robinson said: "On merits, hardly anybody could possibly prefer Milton Friedman to Keynes or to Kalecki, but this does not mean that the influence of Keynes will prevail over the influence of Milton Friedman."

A review of Friedman's *Essays in Positive Economics* (1953a) appeared in the *Financial Times* of February 8, 1954, apparently the first-ever mention of Friedman in that newspaper. The review, which got Friedman's name wrong throughout (calling him Friedmann),⁸⁷ was mostly devoted to Friedman's argument for floating exchange rates (Friedman, 1953b). The review said that Friedman "grossly overstates his case... when claiming that flexible exchanges would have obviated the sterling crises of 1947, 1949, and 1951." The review apparently regarded Friedman as neglecting the possibility that devaluation could worsen the current account balance measured in pounds. This was one of several critiques of Friedman's argument for floating exchange rates that took Friedman as implying that a float removes current account deficits in the balance of payments. It is true that Friedman generally regarded depreciations as good for the sterling trade balance and that a low enough sterling exchange rate would remove the trade deficit; he said so in his 1953 letter to *The Economist*, for example. But, to my knowledge, Friedman did not claim that a floating exchange rate would converge to the value consistent with a zero trade or current account balance; his claim for floats was the correct and general one that they eliminated the possibility of balance of payments

⁸⁷ The *Financial Times*' reference to "Milton Friedmann" echoed that of Friedman's *Economic Journal* referee in 1938, and is one of many variants of Friedman's name that have appeared in print over the years. Apart from the evergreen (and typographically natural) "Milton Freidman" (see e.g., Laidler 1975, p. 58; Hallman, Porter, and Small, 1991, p. 841), Friedman has been referred to as Martin Friedman (Hamlin, 2000, p. 256) and Miles Friedman (*Toronto Telegram*, December 1, 1970); in addition, a review in *The Scotsman* (October 5, 1973) of a book on inflation by Irving Friedman (1973) took the author to be one and the same as "the distinguished American economist... Prof. Friedman." Other sources have endowed Friedman with a hitherto unknown middle initial; so he has been called Milton D. Friedman (Tilman, 2001, p. 130), Milton F. Friedman (Joint Economic Committee, 1974, p. III; Jacobs, 1974; Khan, 1977), Milton H. Friedman (Kimball, 1996), Milton I. Friedman (Owings, 1973, p. 142), Milton J. Friedman (Thompson, 1983; and many others), Milton L. Friedman (*Arizona Republic*, April 10, 1974), Milton M. Friedman (Hanes, 1999), Milton R. Friedman (Carney, 1999, p. 77), and Milton S. Friedman (Linder, 1970, p. 171; and many others). A minor source of the confusion is that there was a Milton R. Friedman in the field of property law, who authored the three-volume *Friedman on Leases* (M.R. Friedman, 1974). For the record, Anna Schwartz has stated (in an email to the author, April 7, 2008) that she is unaware of Friedman having any middle initial.

deficits or surpluses, so that “[b]alance of payments problems in the technical sense are a reflection of price fixing...”⁸⁸

The *FT* review concluded with the point that “the title of the book is a misnomer... [I]n the [exchange rate] essay the author clearly advocates what, in his opinion, ought to be... Likewise, in ‘A Monetary and Fiscal Framework for Economic Stability’ he advocates a system of 100 per cent reserve requirements for bank deposits and various other drastic changes... [T]hey are certainly not essays in positive economics.”

A review by Cambridge University’s Frank Hahn in *Econometrica* later in 1954 opened where the *FT* had left off: “The title of this book is highly misleading,” said Hahn (1954, p. 399). Hahn quickly continued that “many of the essays are highly unsatisfactory.” The review began a tradition that would continue in each decade into the 1990s, whereby Hahn would take time out from his technical contributions to write a more accessible piece blasting Friedman. In the review, Hahn took issue with Friedman’s discussion of the United Kingdom in his floating rate essay, questioning how Friedman could so confidently attribute “Britain’s postwar balance of payment[s] problems... to fixed exchange rates!” (Hahn, 1954, p. 400.) Hahn apparently took, as had the *FT* reviewer, Friedman as claiming that floating rates would remove trade or current account imbalances.

Hahn also objected that “Professor Friedman’s dislike of the Walrasian system is inexplicable in one who puts such faith in the price mechanism.” This objection is unlikely to have moved Friedman; he saw support for the price mechanism in many pre-Walras contributions to economics—in the work of Adam Smith and Alfred Marshall, to name but two. While Friedman accepted the validity of Walrasian analysis in principle and appealed to it in defining the concept of the natural rate of unemployment (in Friedman, 1968b), he did not regard the market-by-market level of detail associated with such analysis as a necessary condition either for valid price theory or valid monetary analysis. On those occasions where he used an explicit model for monetary analysis, Friedman’s use of concepts such as aggregate output and the general price level implicitly meant aggregation across markets, thereby abstracting from the individual-market analysis of Walras and Hahn. And when it came to analyzing individual markets,

⁸⁸ September 23, 1971, testimony, in Joint Economic Committee (1971, p. 701). A detailed discussion of Friedman’s views on open-economy issues will follow in a projected companion paper covering 1980–2006. See also Boyer (2009) for a recent analysis of Friedman’s open-economy framework.

Friedman preferred partial-equilibrium analysis. His confidence in “the enormous efficiency of a market-price system to adapt changing demands to changing supplies” (*Newsweek*, December 31, 1973) arose less from a formal comparison of the allocation with nonmarket methods, than from doubt that nonprice methods could possibly carry out the task efficiently. Even in principle, the task of designing a workable non-market-based allocation system involved a “million and one” decisions for which “I am not enough of an expert—no one is” (*Newsweek*, December 31, 1973).

Revealingly, Hahn judged that Friedman’s book failed to meet either “the high standard of the deservedly famous Friedman-Savage articles on utility” or the “high standard we associate with his [Friedman’s] name.” (Hahn, 1954, pp. 399, 401). These phrases capture the shifting view of Friedman over the 1950s in both U.K. and U.S. academia. The assessments that Friedman was “treated as though were some kind of nut”⁸⁹ (in the words of Robert Lucas) and was perceived as premier among a “not quite respectable collection of eccentrics” (in the summation of Davis, 1969, p. 119), are accurate in describing the reception given Friedman in the 1950s and 1960s. Yet they seem jarring when one considers Friedman’s prestige among economists in the 1940s. The change in outlook reflected increasing reservations about Friedman’s choices on what subjects to tackle and how to tackle them. With respect to *how*, Friedman was exiting the mathematical-rigor door at precisely the time that the profession *en masse* was entering it. His project on the consumption function, which he was presenting at seminars during his 1953–54 spell in the United Kingdom, was his last major work to use an explicit, stochastic model, and the resulting 1957 book may have been the last-ever work of Friedman’s that Hahn actually liked.⁹⁰ With respect to choice of subject matter, Friedman was perceived as going off the rails by focusing on a critique of Keynesian economics, and attempting to build an alternative framework with monetary policy at its center. The forty-plus Friedman, famously characterized by Robert Solow as having reached a state where “everything reminds Milton of the money supply,”⁹¹ was seen as an altogether different proposition from the twenty- and thirty-something probability-oriented microeconomist whose work had earned Friedman the John Bates Clark Medal.

⁸⁹ In Klamer (1983, p. 52).

⁹⁰ Hahn (1990, pp. 542–543) offers rare praise for Friedman’s work, when discussing Friedman (1957a).

⁹¹ Solow (1966, p. 63).

ISSUES, 1946–1959

KEYNESIAN LEGACY

“The FINANCIAL TIMES regrets to announce the death of Lord Keynes, the famous economist,” began a front-page item in the newspaper’s edition of April 23, 1946. Over the following sixty years Friedman would repeatedly return to the questions of what were Keynes’ views and what was their relation to the views of his followers.

A 1980s Chancellor of the Exchequer, Nigel Lawson, would state that, “Unlike most of the Keynesians, Keynes was of course a free-market man through and through” (Lawson, 1988, p. xvi), and similarly Friedman’s former student, Samuel Brittan, wrote early in his career that Keynes favored only “limited and prudent State intervention” (*Financial Times*, November 19, 1956). Friedman’s own assessment conflicted with these judgments. Friedman referred in 1967 to Keynes’ “confidence in civil servants”⁹² and later to “Keynes’ elitist political philosophy” (*The Economist*, June 4, 1983). These were not virtues as far as Friedman was concerned: amid the economic problems of 1974, Friedman judged, “Elitism has led to where we are now.”⁹³ Further, Friedman associated the growth of government with “the tendency of intellectual elites to denigrate ordinary people and to believe that they should run the government” (*Wall Street Journal*, January 8, 1991). “[Keynes] was a liberal in the nineteenth-century sense,” Friedman said in a 1994 television interview, “but he was also an elitist, and he believed that there was a group of able public-spirited intellectuals who should be given charge of society.” (CSPAN, November 20, 1994.)

As discussed further below, Friedman was generally sympathetic with the idea that Keynesian economics, particularly in the United Kingdom, took a more extreme form than Keynes would have liked.⁹⁴ But Friedman eventually concluded that key aspects of Keynesian economics to which monetarism was opposed were, in fact, due to Keynes. In particular, while it was common for Keynesians in the 1970s and 1980s to downplay the role of the liquidity trap in Keynes’ framework, Friedman always maintained that Keynes’ *General Theory* endorsed the notion of the liquidity trap; and while U.K.

⁹² Friedman (1967, p. 9 of original; p. 88 of 1969 reprint).

⁹³ In AEI Roundtable (1974, p. 23).

⁹⁴ See, for example, Friedman’s May 25, 1959, testimony in Joint Economic Committee (1959a, pp. 606, 608); Friedman (1970a); and *The Economist*, June 4, 1983.

Keynesian Alec Cairncross said that Keynes rejected fine-tuning,⁹⁵ Friedman judged that Keynes was “something of a fine-tuner, [who] tended to neglect the cumulative effect of short-run policies” (*The Economist*, June 4, 1983).

In addition, Friedman and Schwartz (1982, p. 623) noted that “Keynesian theory supposes prices to be determined by nonmonetary forces.” Friedman was initially inclined to accept that “Keynes himself was not guilty” of holding this position (Friedman, 1961a, p. 1052). But later rereadings of the *General Theory* convinced him that this was not the case and that while Keynes did believe in a *ceteris paribus* long-run quantity-theory relation between money and prices under certain circumstances—for example, in the wartime conditions of excess demand—Keynes had endorsed cost-push inflation as a distinct, self-sustaining force at all levels of demand (Friedman, 1970a, 1972b; Friedman and Schwartz, 1982, pp. 47, 61). Friedman’s interpretation of Keynes on this score is backed up by Keynes’ 1940s writings (see e.g., Moggridge, 1990; Nelson and Schwartz, 2008) and by Tobin’s (1983) pointing to Keynes’ endorsement of incomes policy.

Where Keynes’ followers “went further,” Friedman argued,⁹⁶ was in generalizing his critique of the ability of monetary policy to affect aggregate demand. By emphasizing the interest inelasticity of investment, Friedman noted, postwar Keynesians tended to take a more extreme position than Keynes—the superiority of fiscal policy over monetary policy as an effective device for governing demand, stressed by Keynes as pertaining to Depression conditions, was being taken to hold globally.

Friedman not only urged that Keynes should not be judged by the views of his followers, but that other monetary economics of Keynes should be remembered beside that in the *General Theory*. “Keynes’ greatest book,” Friedman (1972c, p. 16) contended, “[was] his *Tract on Monetary Reform*, which most of you people have never heard of or never read.”

⁹⁵ See *Evening Post*, July 9, 1983. In addition, a friend of Keynes said that Keynes “was certainly no exponent of a continuous fiddling with the economy” (*Financial Times*, March 5, 1975).

⁹⁶ See his May 25, 1959, testimony in Joint Economic Committee (1959a, p. 606); also, Friedman (1968c, p. 439).

THE EARLY MONETARIST

Two beliefs are widespread about Friedman's origins as a monetarist. The first belief is that his earliest monetarist work appeared in 1956.⁹⁷ The second (due especially to the discussions of Friedman's work by Don Patinkin, Harry Johnson, and Paul Samuelson) is that in the 1956 paper and elsewhere Friedman merely dotted the *i*'s and crossed the *t*'s of existing work by Keynes and of pre-1956 Keynesian work, so that the theoretical innovations of monetarism were negligible (at least if contributions regarding the expectational Phillips curve are put to one side). Both beliefs are misconceptions. They are naturally handled together since the non-Keynesian aspects of Friedman's framework are not all present in his 1956 paper, but are evident if the totality of his work over 1948–58 is considered. The discussion below shows that the literature's characterization of the 1956 paper as the launch-pad for Friedman's monetarism has obscured some of the major theoretical differences with Keynesianism that were already visible in other work by Friedman in the 1950s.⁹⁸ It complements the cataloguing by Friedman (1972a) and Meltzer (1977) of distinctions between Friedman's framework and Keynesianism, but includes items not in their lists. It also serves to confirm Friedman's observation (in his *Reason* interview of June 1995) that the key arguments he made in his 1960s and 1970s publications were already present in his 1950s work.

First, Friedman argued as early as 1948 for a focus on monetary policy for the control of inflation. A letter he and other Chicago faculty members wrote to the *New York Times* in early 1948 was entitled "Control of Prices: Regulation of Money Supply to Halt Inflation Advocated." (January 11, 1948.) In claiming that "a marked increase of the general level of prices unaccompanied by a marked increase in the supply of money is a rare if not nonexistent phenomenon," this letter reflected early dissent by Friedman from Keynesianism,⁹⁹ and was followed by Friedman's (1950, p. 474) sympathetic remarks about the quantity theory. In 1952, as a Lionel Robbins letter discussed below indicates, Friedman was firmly associated with the quantity theory position, and Friedman published his finding that income and price changes in U.S. wartime episodes were

⁹⁷ See, for example, Eshag (1983), and textbook treatments such as Baumol and Blinder (1979).

⁹⁸ I do not include the permanent income hypothesis in this list because many (including Friedman on occasion) regarded it as a development of, rather than a challenge to, Keynesian theory.

⁹⁹ Brunner and Meltzer (1993) date Friedman's earliest dissent to Friedman (1944).

“more readily explicable by the quantity theory than by the income-expenditure theory” (Friedman, 1952, p. 721).¹⁰⁰

Second, Friedman (1951) argued for treating prices and wages as endogenous variables at all levels of employment, in contrast to the Keynesian treatment (and Friedman’s in 1942–43) of prices as insensitive to aggregate demand until full employment was reached.

Third, Friedman advocated floating exchange rates from 1950, when his (1953b) essay on the subject was drafted, using arguments which rested on the ability of monetary policy to deliver price stability.

Fourth, in the 1950s Friedman rejected cost-push factors as a source of sustained inflationary pressure. While Friedman (1948) had given credence to cost-push factors as one factor driving up wages, in Friedman (1951, p. 228) he said, “My views about this have changed considerably in the last few years.” In 1952 Friedman testified, “I think the so-called wage-price spiral has been enormously exaggerated, that what we have had has been inflationary pressure pulling both wages and prices up.”¹⁰¹ His rejection of cost-push is clear also in his repudiation in Friedman (1953b) of the idea that exchange rate depreciation could trigger a self-sustaining wage/price spiral. Friedman’s position from the early 1950s was that cost-push factors had a zero mean in themselves; upward pressure on wages or prices in one sector would be “balanced by declines elsewhere in other prices and costs.”¹⁰² Any tendency for inflation to exhibit a sustained rise in the face of a positive wage or price shock reflected monetary accommodation, so cost-push factors could not alter inflationary expectations in the absence of a monetary expansion. This rejection of cost-push distinguished Friedman not only from Keynesians (among whom the popularity of cost-push explanations *increased* over the 1950s, in both the United States and the United Kingdom) but also from some advocates of monetary control such as Robbins. In contrast to Friedman, Robbins believed that wage-push factors put a positive bias into U.K. wage inflation, in the face of which monetary policy

¹⁰⁰ Friedman had also confronted Roy Harrod with his views on velocity in a meeting in Chicago in early 1951 (Harrod, 1971, p. 58).

¹⁰¹ March 25, 1952, testimony, in Joint Committee on the Economic Report (1952, p. 727); see also Friedman (1952, fn. 7).

¹⁰² March 25, 1952, testimony, in Joint Committee on the Economic Report (1952, p. 736).

needed to be contractionary (rather than simply non-accommodating) to deliver price stability.¹⁰³

Fifth, Friedman rejected the notion of a long-run trade-off between unemployment and inflation. Asso, Kahn, and Leeson (2007) note that this was a theme in Friedman's writings well before the usually cited articles of the late 1960s, and provide instances from his 1958–62 output. Additional evidence can be found by looking further back. In a 1950 symposium (All Participants, 1951, p. 243), Friedman said "I don't know what you mean by saying unemployment will police inflation." In 1952 Congressional testimony he said, "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 by avoiding a good many of the interruptions to output that we have had in the past, by giving people stable expectations, and so on."¹⁰⁴

Sixth, the preceding two points combined with his doubts about fiscal policy meant that Friedman believed that monetary policy was *sufficient* to control inflation. The "sufficient" language was used in Friedman (1958c), and contrasts Friedman's position directly with Keynes' view that monetary policy actions could not be sufficient for delivering price stability (see Nelson and Schwartz, 2008).

Turning now to contributions present in Friedman (1956), a seventh 1950s contribution of Friedman was to specify money demand as dependent on a vector of interest rates. This is a condition for the monetary policy transmission mechanism not to be capable of being summarized by a single interest rate. Patinkin (1969) claims that Friedman's specifying money demand dependent on interest rates makes his specification Keynesian. This overlooks the fact that Friedman does not condense the nonmoney assets into a single asset, as Keynesian analysis typically did. Moreover, pre-Keynes writers had made money demand interest elastic, and the specifics of Friedman's money demand approach differ from Keynes. Keynes had broken money demand into transactions and

¹⁰³ Note that the view that unions can be an autonomous source of wage-push is distinct from the view that unions can raise the natural rate of unemployment, since wage- or cost-push refers to inflationary pressure created for a given difference between unemployment and the natural rate. As for whether union pressure could affect the natural rate, Friedman regarded the conditions for this to occur as restrictive—he argued that unions could raise unemployment in certain sectors, but not necessarily in the aggregate (Friedman, 1951; *The Times*, August 29, 1973; *The Economist*, September 28, 1974a)—but he sometimes implied that the conditions for an effect on aggregate unemployment might have been satisfied in the postwar United Kingdom (e.g., Friedman 1963a; Friedman and Friedman, 1980).

¹⁰⁴ March 25, 1952, testimony, in Joint Committee on the Economic Report (1952, p. 727).

speculative components, with only the second component interest-elastic and otherwise “idle.” Friedman (1956) rejects the concept of idle money and instead models every unit of money as interest elastic (possibly relative to own-rates), and held for all motives at the same time (an aspect of Friedman’s analysis acknowledged by Patinkin, 1965, p. 75).

Eighth, Friedman (1956) indicates that his conception of money demand rules out the liquidity trap, which he argued in Friedman (1972a) was central to the *General Theory*. In light of the discussions of liquidity trap in recent years by Paul Krugman and Lars Svensson,¹⁰⁵ and their attribution of liquidity-trap views to Keynes, it may come as a surprise that Patinkin (1972a) and many other Keynesians objected to Friedman’s association of the *General Theory* with the liquidity trap. But it was hardly an off-the-wall interpretation on Friedman’s part. James Schlesinger, by no means a close ally of Friedman, argued strongly that the liquidity-trap thesis was central to the *General Theory* in his 20-year retrospective on the book. Schlesinger (1956), Friedman (1972a), and Beenstock (1980) all provide their own, apparently independently constructed, lists of quotations from Keynes (1936) supporting this interpretation, and even Patinkin (1976a) acknowledged that passages of the *General Theory* treat the liquidity trap as empirically relevant. As Friedman (1972a, p. 942) put it, again and again, Keynes’ “final line of defense is absolute liquidity preference.”

Over 1948–58, all the elements of Friedman’s monetarism fell into place, and are recognizable as the positions he took in what he termed the “dispute in the 1950s or early 1960s” in the United States¹⁰⁶ and in the subsequent debate around the world from the late 1960s. This crystallization of Friedman’s framework was occurring at a time when, in the United Kingdom, the dominant thinking on monetary policy was converging toward an almost completely different framework.

THE ROAD TO RADCLIFFE

Friedman (1968c, p. 439) noted, “Experience with monetary policy after World War II very quickly produced a renewed interest in money and a renewed belief that money matters.” But later, viewing the 1950s and 1960s as a whole, Friedman (1987, p. 13) concluded that the experience of the period “strongly reinforced” the Keynesian critique

¹⁰⁵ See, e.g., Krugman (1998) and Svensson (2003).

¹⁰⁶ Friedman (1977c, p. 12).

of monetary policy, and Friedman and Schwartz (1982, p. 17) argue that the revival of the quantity theory of money did not really take off until the 1960s. Evidently, the 1951 abandonment of cheap money policies was not quite as great a breakthrough as Friedman and other advocates of monetary policy had imagined. What went wrong?

Friedman was, on the whole, pleased with the course that monetary policy followed in the United States during the 1950s. But even in the U.S. case he was uneasy about the continuing emphasis on fiscal and other nonmonetary influences when it came to accounting for economic fluctuations; thus Friedman (1955, p. 32) referred to “the intellectual climate of today and the recent past, with its derogation of the significance of monetary factors....” Furthermore, diagnoses of inflation were becoming less orthodox, with the growing appeal from the mid-1950s of explanations that downplayed demand factors and instead stressed “cost-push.”

In the United Kingdom, the trends against monetary policy were even stronger. The ending of cheap money was more hesitant; certainly interest rates were raised in 1951, but they were cut in 1954 while the economy was gathering steam. The really concerted tightening of monetary policy in the United Kingdom in the 1950s was concentrated in the years 1955–58, which may be why Friedman (1963b, p. 7) once said that the U.K. cheap money period ended “a few years” after 1951. The tightening began with increases in Bank Rate in January-February 1955 under Chancellor of the Exchequer R.A. Butler, and was followed by further increases under his successors in 1956 and 1957. The 1955–58 subperiod distinguishes itself from the preceding and subsequent epochs by the extent to which the authorities were attributed interest in control of the stock of money. For example, *Financial Times* columnist Harold Wincott contemplated what would happen “if Mr. Butler continues with his policy of contracting the supply of money and credit” (*Financial Times*, October 4, 1955), while the *FT*’s “Lombard” commentator said that the “ultimate aim of the Government’s credit restriction drive is, *of course*, to exert a downward pressure on the supply of money strong enough to keep spending power within the limits of the country’s available resources” (November 30, 1955; my emphasis). Sir Oliver Franks, Chairman of Lloyds Bank, was a prominent supporter in the financial community of the emphasis on the money supply, his view being that a “moral of recent events is thus the importance of keeping a tight rein upon the volume of bank deposits as one of the main determinants of the flow of spending” (*FT*, January 26, 1956). In the September 1957 round of tightening, policymakers themselves became

very explicit about their intention to restrict the money supply, with speeches to that effect by the Prime Minister (Harold Macmillan) and Treasury ministers.

The emphasis on monetary aggregates at this early stage may seem anomalous, as the official money series (M0, M1, M3, etc.) that would come into existence in later years were not available. Many have noted that U.K. money supply data were not available to Keynes when he wrote on monetary affairs (see e.g., Patinkin, 1976b), and Walters (1970) conjectures that a historical series for money the United Kingdom was not put together until the early 1960s. One should not exaggerate the absence of monetary data, however; the weekly release of the Bank of England's balance sheet gave most of the information needed to construct currency and monetary base series; and the various releases of the clearing banks and other institutions provided information on deposits. These releases were the subject of regular attention in the financial press.¹⁰⁷ The main problem for potential investigators of monetary relations was constructing long series free of breaks and double-counting. It was also well known that the basic data for constructing a long historical money series were available far back for the United Kingdom; Friedman (1961b, p. 270) referred to the availability of U.K. deposit data back to the 1870s.

The would-be revival of monetary policy in the United Kingdom suffered severe criticism once the 1955 interest-rate increases failed to deliver the desired results during the year. The *Guardian's* Financial Editor had already claimed, "It is now generally agreed that the experiment of checking inflation by monetary policy alone has not been a success." (*Manchester Guardian*, December 12, 1955); similarly, an editorial in *The Scotsman* (March 26, 1956) said of 1955, "A sharp rise in Bank Rate... was powerless to check inflation."

To many critics, the apparent failure of monetary policy to deliver low inflation vindicated the notion that monetary policy was ineffective because aggregate demand was interest-inelastic. This notion, already embodied in the *General Theory* to some extent,¹⁰⁸ had been reinforced in the United Kingdom in the prewar and early postwar

¹⁰⁷ For example, for much of the 1940s and 1950s there was regular space devoted in the *Financial Times* to the Bank of England's balance sheet release. Deposit data were discussed regularly too; for example, in the *Financial Times* of November 30, 1955.

¹⁰⁸ See, for example, the passage cited in Patinkin (1976a, p. 103). This interpretation of Keynes was also made by John Strachey, a Member of Parliament and former Attlee Government Cabinet minister whom

period by surveys of firms carried out by Oxford University. The survey results seemed, as discussed, for example, by Schlesinger (1956, p. 603), to vindicate the view that firms' investment decisions were interest-inelastic (and with them the whole of aggregate demand, as most Keynesian work had already narrowed the interest-rate channel to investment).

Friedman was scathing about the value of questionnaires of businessmen. "That is not evidence... I do not care what they have said," he said on a panel in 1950.¹⁰⁹ In 1979, Friedman added, "Economics is a serious subject, and one of the things we've learned in that subject is that if you want to know how people behave, you don't ask them. You look."¹¹⁰ The joint behavior of real returns and the stock of productive capital led Friedman to believe that investment was instead "highly elastic" with respect to real interest rates (Friedman and Schwartz, 1982, p. 494). Friedman's reaction to the survey results paralleled that of his hero Dennis Robertson, who had said in 1949 that he had "a hunch that the reaction among the neo-Keynesians against the importance of the causal influence of the rate of interest on capital outlay has been carried too far... Does anyone here, I wonder, share my doubts—my very respectful doubts—about the significance of those replies to questionnaires...?" (Robertson, 1949, p. 20.)

As 1955 proceeded, believers in the interest-insensitivity of aggregate demand now thought they had something more concrete than the surveys, namely, the maintenance of U.K. boom conditions in 1955 alongside monetary tightening. This was not the sort of evidence that would impress Friedman; his theoretical work on stabilization policy had already emphasized the lags in the effect of economic policy actions, increasingly backed up by his ongoing work with Anna Schwartz on the historical effects of monetary policy actions in the United States.

Keynesians not only doubted the effectiveness of monetary policy as a demand-control measure; they argued that efforts to control inflation via demand measures might in any case be misguided. The *Financial Times* editorialized during the initial tightenings that there was "still something of a mystery about the origins of the inflationary forces threatening the British economy" (February 15, 1955). Despite the use of monetary

Friedman would later debate in print (Friedman, 1957b). Strachey (1956, p. 280) both attributed to Keynes, and himself endorsed, the notion of a low or zero interest elasticity of aggregate spending.

¹⁰⁹ Friedman, speaking in *All Participants* (1951, p. 251).

¹¹⁰ In Anderson (1982, pp. 201–202).

policy tightening, policymakers shared the view that much inflation was cost-push in character, a view evident in their repeated attempts at securing agreements on wage determination. Even in 1957, at the height of the deployment of monetary policy against inflation, Treasury official Sir Robert Hall testified, “by and large the government has not used monetary policy as an instrument primarily to be used to secure stable prices... [T]he Government view has been, I think, that there has been what economists would call an institutional factor [behind inflation].... That has been behind the continual pleas for [wage] restraint...”¹¹¹ In 1975, Sir John Hicks acknowledged that U.K. policymakers in the 1950s and 1960s had erroneously cited special factors as behind inflation when inflation had been due to excess demand after all (*Irish Times*, May 14, 1975).

The skeptical sentiments regarding monetary policy made by Keynesians since the 1930s were synthesized and consolidated in the report on monetary policy delivered by the Radcliffe Committee to the U.K. government in August 1959. The Radcliffe Report argued that monetary policy was ineffective. It did not rely on the liquidity trap argument, but used lines of reasoning that delivered much the same ineffectiveness result as the liquidity trap.¹¹² Whereas Keynes’ liquidity trap argument said that money and government securities could become equivalent at a low interest rate, the Radcliffe Committee argued that important asset prices were unaffected by open market operations that switched money for short-term securities, even when these operations changed the short-term interest rate. Thus while open market operations could alter policy rates, they affected only the composition, not the aggregate, of “liquidity,” which was the financial quantity that really mattered; financial innovation, it was argued, had eliminated much of the difference between money and Treasury bills. The interest rates that policy could affect, the Committee argued, mattered negligibly for aggregate demand, while the asset prices that did matter for aggregate demand depended on the “liquidity” total, which was generally not susceptible to central bank manipulation. The Committee also endorsed cost-push views of inflation.¹¹³ The Committee seemed to be successful in bringing round some previous advocates of monetary control: Sir Oliver Franks was a member of the Committee and joined the unanimous endorsement of the Report (Kaldor, 1982, p. 5), and Harold Wincott, the *Financial Times* columnist in whose memory Friedman (1970a)

¹¹¹ Sir Robert Hall, testimony of October 17, 1957, in Radcliffe Committee (1960a, pp. 98–99).

¹¹² Cramp (1962, p. 14) makes the important observation that the “Radcliffe theory may thus be seen as part development and part criticism of Keynes.”

¹¹³ See Radcliffe Committee (1959) and for specific references to the relevant sections, see e.g., Laidler (1989) and Nelson (2009).

would later give a lecture, went from an advocate of monetary policy in the 1950s to a “Radcliffian” in the 1960s.

Friedman and Schwartz (1982, p. 52) observe that the Radcliffe Committee was “faithful to Keynes” in emphasizing the ineffectiveness of monetary policy arising from the alleged equivalence of money and bonds. But the Committee, by claiming that monetary policy was ineffective generally, not just in Depression conditions, was taking a harder-line position than Keynes usually did. The Committee’s basis for this conclusion was that financial innovation—e.g., the growth of nonbank intermediaries—put the determination of important asset prices outside the reach of monetary policy. While the emphasis on financial innovation did not have a counterpart in Keynes’ *General Theory*, it paralleled the approach that Gurley and Shaw (1960) were taking in analyzing U.S. financial behavior. Noting the connection, Friedman and Schwartz (1970b) treated the Gurley-Shaw and Radcliffe as advocates of the same “liquidity” argument, while Friedman and Schwartz (1982, p. 209) referenced Radcliffe with Gurley-Shaw together when citing studies that minimized the significance of money and monetary policy actions. Monetarists were not impressed by the Radcliffe/Gurley-Shaw arguments from the beginning, and the monetarist side of the argument was what—eventually—won the day in the economics profession. Brunner (1985, p. 22) observed witheringly that there really was “no logical link between negative conclusions bearing on monetary policy, and the discussion of financial innovations... Gurley and Shaw argued more than 20 years ago that the explosive growth of savings and loans associations erodes the potency of monetary policy. The subsequent evolution discredited such fears or hopes.”

Friedman’s initial public response to the Radcliffe Report was muted. Alvin Marty thanked Friedman for “exceedingly helpful substantive comments” on a paper published in early 1961 in which Marty said the “Radcliffe Report is a striking example of failure to offer a shred of evidence.”¹¹⁴ In a book review published at the end of 1961, Friedman (1961a, pp. 1052–1053) noted the problems in defining “liquidity”; in 1964, he said that the Radcliffe Committee’s liquidity concept was “an undefined term which covers the universe,”¹¹⁵ while Friedman and Schwartz (1970b, p. 130) added that the Radcliffe Committee itself could not settle on a firm liquidity definition.¹¹⁶ Friedman denounced

¹¹⁴ Marty (1961, pp. 56, 59).

¹¹⁵ Friedman (1964b; p. 73 of 1969 reprint).

¹¹⁶ The critical discussion of the Radcliffe Committee in Friedman and Schwartz (1970b) was originally part of their unpublished first draft of their *Trends* study (Friedman and Schwartz, 1966).

the theories offered by the Radcliffe Committee as “a false trail that will not in fact be productive” (Friedman, 1963b, p. 9) and went on to applaud the negative reception the Radcliffe Report had received among “academic economists and others.”¹¹⁷ Friedman’s appraisal that the Report had been received negatively rested largely on the U.S. reaction; in the United Kingdom, many policy and academic figures greeted the Report favorably.

In U.K. policymaking, confidence in monetary policy restriction as the cure for inflation reached its peak in 1957 and was followed by a period of substantial monetary policy easing. Friedman (1980c) argued that the shift to expansionary policies (both monetary and fiscal) in the United Kingdom from the later 1950s onward was a vindication of his (1954) prediction. He had predicted that overreaction to actual or prospective minor recessions would produce a tendency for the authorities to over-expand. Complementing this explanation is the fact that the U.K. authorities after 1957 were much more inclined to view incomes policies as the appropriate means of fighting inflation. Even when inflation fell in the late 1950s, to the point of delivering price stability in 1960, the success was attributed to favorable cost-push shocks rather than to the 1955–58 restrictive monetary policy. For example, *The Economist* (August 29, 1970) attributed the fall in inflation from 1958 to 1960 to less militant union behavior after the defeat of the 1958 London bus strike.

PERSONALITIES, 1946–1959

RICHARD KAHN

As the founder of fiscal multiplier analysis (Kahn, 1932), Richard Kahn was a giant in Keynesian economics, and Friedman’s work on multiplier analysis in Friedman (1963b) and Friedman and Meiselman (1963) included a parameter (K) explicitly named in honor of Keynes and Kahn. By the time of Friedman’s visit to Cambridge University in 1953–54, Kahn had cut down his research output and was engaged in what he later described as “ephemeral” activities discussing current policy developments (Kahn, 1984, p. 258). It was through one of these activities, a radio program, that Kahn had a debate with Friedman broadcast nationally in October 1954.

¹¹⁷ Friedman (1964b; p. 73 of 1969 reprint).

The radio program was entitled “Stabilization of Commodity Prices,” and probably covered the general subject of inflation rather than commodity prices narrowly interpreted. The participants were Friedman, Kahn, and the London School of Economics’ Frank Paish. The three participants happened to represent the three major positions that emerged in the economics profession in the debates over the following decades. Friedman took a monetary view of inflation and rejected any long-run unemployment/inflation trade-off; Kahn took the cost-push line; and Paish, the view that inflation responded to aggregate demand in a manner that implied a permanent inflation/unemployment tradeoff.

Unfortunately, there seems to be no record of the debate that took place, either in the form of a transcript or in contemporaneous commentary on the broadcast. Even the same-day treatment of the program in the newspapers’ radio listings was sparse, with only the *Manchester Guardian* (October 5, 1954) listing Friedman and the other participants, the other papers simply giving the program title. The *Daily Express*, a publication that would go on to print in-depth interviews with Friedman in 1976 and 1980, snubbed Friedman on this occasion by not only not giving participants’ names in the radio listing for the debate, but including in its list of the day’s radio highlights the two programs preceding Friedman’s but not the show that he appeared on.

Despite his diminished role in academic debates after the 1930s, Kahn has repeatedly been named as one of the key figures responsible for making U.K. Keynesian economics as extreme as it became on monetary matters in the postwar period. For example, Robert Solow criticized “what one might describe as English Keynesian economics, the economics of Richard Kahn and Nicholas Kaldor”;¹¹⁸ Alan Walters said that what dominated postwar U.K. economics was not Keynes’ thinking but “Kahn-Kaldor-Harrodian” Keynesianism;¹¹⁹ Harry Johnson referred to the “Kaldor-Kahn-Radcliffe view of money”;¹²⁰ and Friedman gave Kahn pride of place when listing the Keynesians present at Cambridge in the 1950s (Friedman and Friedman, 1998, p. 246). Kahn’s participation in debates on economic policy in the media, and his advice to government inquiries such as the Radcliffe Committee,¹²¹ seem to have kept up his profile as a leading Keynesian. Kahn was not quite as extreme as some of his fellow Keynesians, as

¹¹⁸ In Klamer (1983, p. 135).

¹¹⁹ Walters (1978, p. 285).

¹²⁰ Johnson (1975, p. 23).

¹²¹ See Laidler (1989) for a discussion of Kahn’s contributions to the Radcliffe Committee.

he accepted that the Bank Rate mattered for interest rates that in turn mattered somewhat for aggregate demand. But having conceded some elasticity, he still maintained that “business is rather unresponsive to monetary policy” (*Financial Times*, June 4, 1954).

In the 1970s, Kahn was not as high-profile a critic of Friedman as Nicholas Kaldor, with whom he served as a member of the House of Lords. But a set of lectures given in 1978 (published as Kahn, 1984) gave Kahn the opportunity to voice his own critique. Although the introduction to the lectures claimed that the book would not include discussion of modern policy developments, monetarists nevertheless received the wrath of Kahn in the book’s concluding pages, being judged practitioners of “black magic economics” that was “responsible for worldwide economic recession.” (Kahn, 1984, p. 243.)

LIONEL ROBBINS

Friedman’s connection with Lionel Robbins stretched back all the way to late 1934, when Friedman was part of a team at the University of Chicago putting together a collection of papers by Frank Knight. In their preface, Friedman and his three coeditors state that they “are greatly indebted to Professor Lionel Robbins of the London School of Economics” for suggestions (Friedman *et al*, 1935, p. 7). But Friedman was not sympathetic to the interpretation of the Depression being offered by Robbins at the time, which he characterized in Friedman (1972a, pp. 938–939) as the fatalistic view that the Depression reflected the earlier boom and needed to work itself out.

After World War II, Robbins had repudiated his 1930s analysis of the Great Depression (see e.g., Robbins, 1974, p. 21). Nevertheless, he became known as a critic of Keynesian economics as practiced in the United Kingdom, in particular the ambitious targets for full employment and the minimalist role assigned monetary policy. Robbins acknowledged, publicly and privately, being influenced by Friedman’s early monetarist activities. In a 1952 letter to Friedman, Robbins said that the topic he would prefer to hear Friedman lecture on was the comparative empirical validity of Keynesian and quantity-theory analyses. Robbins indicated that Friedman had discussed this topic with Robbins at their previous London meeting (that is, in 1948 or 1950).¹²² During the 1950s, Robbins was

¹²² February 6, 1952 letter from Robbins to Friedman, Hoover Archives.

probably the most prominent advocate in the United Kingdom for the use of using monetary policy to fight inflation.

When the Radcliffe Report was released in 1959, Robbins devoted his first speech as a member of the House of Lords to a critique of the Report. A further critique followed in a book Robbins published in 1961. The written critique took the Committee to task for downplaying the significance of the monetary base and other quantities, and Robbins noted that the Report's tone had not taken into account the warning of W.W. Riefler of the Federal Reserve Board, which Robbins quoted: "The fundamental thing we do is to operate on the reserve position. If we ever forget that, we are gone."

Robbins' critique of the Report mentioned "investigations of this subject by Professor Friedman and his associates," and cited Friedman (1956) as evidence against the Radcliffe Committee's position on velocity.¹²³ References to Friedman's work on money in the U.K. literature were very rare at this point, and favorable references like this rarer still.

4. 1959–1970

EVENTS, 1959–1970

In a new round of monetary policy tightening in July 1961, the Macmillan Government raised Bank Rate to 7%. This was not an unambiguous affirmation of the role on monetary policy, because it was muddled by a simultaneous attempt by the Government at a wage freeze (a "pay pause"). But after a year of tight monetary policy, the Chancellor of the Exchequer, Selwyn Lloyd, showed signs of determination to maintain a restrictive stance: "18 months ago there was excess demand... Now, I think there is a measure of disinflation... I think the economy is in better shape, but you can't have disinflationary measures without there being, in result, a measure of disinflation... That means that some order books will be shorter..." (*Yorkshire Post*, July 11, 1962.) Shortly afterwards, Lloyd was fired. The restrictive monetary policy episode turned out to be only an interruption in the de-emphasis on monetary policy signaled by the Radcliffe Report. The expansionary policies prevailing before 1961 were revived in a more intense form, producing what Walters (1983) termed "the first intensive go-go policy." The

¹²³ Robbins (1961, p. 101).

more expansionary policy was associated with a shift up in money growth, whether measured by the monetary base or by Friedman and Schwartz’s (1982) M2 measure, reversing the moderation in growth observed during the 1961 squeeze (Figure 4). Consequently, while the pickup in U.S. money growth in the 1960s initially exceeded that in the United Kingdom, Friedman and Schwartz (1982, p. 157) note that, from the mid-1960s, “the United Kingdom took the lead—if that is the right word.”

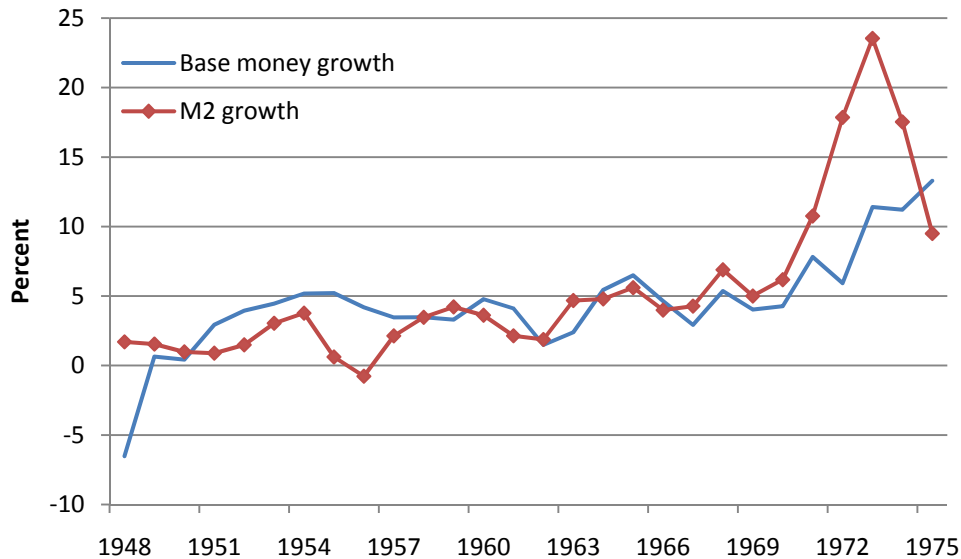


Figure 4. U.K. M2 growth and monetary base growth, 1948–1975, annual data

Friedman viewed the U.K. monetary expansion of the 1960s as contributing to the mood of the country. “[T]he fact is that most people enjoy the most people enjoy the early stages of the inflationary process. Take, for example, Britain in the Swinging Sixties.” (*The Listener*, April 24, 1980.) One aspect of the sustained expansionary policies of the 1960s that did cause concern to the U.K. authorities at the time was one that Friedman would prefer they had been sanguine about: the threat to the exchange rate. The sterling/dollar rate was becoming more difficult to maintain, even with the exchange control apparatus, and speculation against it increased after the Labour Party under Harold Wilson was elected to office in 1964. Friedman (1965, p. 179) said that while he happened to disagree with the policies Wilson had promised to carry out, he found it objectionable that foreign central banks and other holders of sterling were perceived as having a “veto power” over their implementation. He elaborated in September 1965 that this meant “that British internal policy was shaped by officials who were not responsible

to the British electorate.”¹²⁴ Friedman concluded that Wilson, instead of negotiating a sterling rescue, should have floated the pound on coming to office, blaming the predecessor government for the likely depreciation.¹²⁵

The Wilson Government finally did devalue in November 1967, with the 14% adjustment providing another example of what Friedman (1969b, p. 20) called “this awful business of holding and holding and holding to the last gasp and then having to make a big change.” Friedman had anticipated the devaluation and had wanted to speculate \$30,000 against the pound, only to find that his Chicago banks did not have the wherewithal to carry out the foreign exchange transaction (*Sydney Morning Herald*, October 9, 1986). After the devaluation, the Wilson Government started expressing policy commitments to the International Monetary Fund in terms of quantitative financial targets, and in 1969 it announced a target for Domestic Credit Expansion (DCE). Although interpreted as a concession to monetarists, the DCE targets had the decidedly un-monetarist implication of encouraging the authorities to regard money base growth that came from balance of payments surpluses as “good.” The policy framework of a fixed exchange rate, attention to DCE at the expense of the aggregate monetary base, and incomes policies, contrasted with Friedman’s recommendation of a sterling float, no incomes policy, and direct control of the aggregate base or aggregate bank reserves.

Also in 1967, the Wilson Government announced plans to create a “new town” in England. Its name: Milton Keynes. Many have speculated that the name was chosen by the U.K. authorities as a lighthearted compromise between Keynes and Friedman, but the name Milton Keynes was actually a centuries-old name for a village that had existed inside the frontiers of the proposed new Milton Keynes site.

ISSUES, 1959–1970

MONETARISM AND THE QUANTITY THEORY

It is difficult to convey the dramatic shift in the amount of coverage given to monetary policy in the U.K. financial press and political debate in the years 1968 to 1970 compared to the preceding three years 1965 to 1967. The increased degree of coverage turned out

¹²⁴ From Friedman’s 1965 Mont Pelerin Society meeting remarks, published in Friedman (1968a, p. 274).

¹²⁵ See, e.g., his remarks in Friedman and Roosa (1967, pp. 114–115), and his 1968 memorandum in Friedman (1988).

to be permanent. Some flavor is captured by the observation of the magazine *Management Today* (August, 1976): “A decade ago economists, pundits and politicians alike would have amazed to learn that in the mid-1970s debates over monetary policy would have come to dominate the national and international economic scene.”

The upsurge in the coverage of monetary policy was accompanied by greatly increased discussion of Friedman. While “Chicago School” was probably the most widely used term to describe the school of thought emphasizing money (e.g., *The Sun*, October 7, 1968; *The Observer*, April 20, 1969), and “Friedmanite” was used from an early stage (e.g., *Sunday Times*, November 10, 1968), the U.K. debate also rapidly proliferated a term that *The Economist* had used as early as 1963, but which was starting to become prevalent in the United States: monetarist. Robert Solow used “monetarism” repeatedly in an article he wrote for *The Times* (December 23, 1968), and Paul Samuelson criticized “crude monetarism” in a contribution to the *Sunday Telegraph* (December 15, 1968).

Friedman often publicly criticized the terms “monetarist” or “monetarism.” In an interview with *The Times* in 1976, Friedman said, “It is not a new position, and that is one of the reasons I don’t like the word monetarism.” (*The Times*, September 13, 1976.)¹²⁶ Similarly, Friedman (1983a, p. 2) observed, “Personally, I dislike the term ‘monetarist.’ The theory that goes by that label has a perfectly respectable ancient name, namely the quantity theory of money.” As Friedman saw it, he was not launching a new theory, but bringing quantity theorists’ work “down to date,”¹²⁷ so that it could be applied to the problems of the “bad old present.”¹²⁸ But Friedman (1978a) confessed that there was a utility to the term monetarism because there were some elements of older quantity theory work that he and other monetarists had discarded. In particular, an aspect of earlier quantity theory analysis which Friedman explicitly rejected was regarding velocity behavior as the outcome of an institutionally-determined payments process, instead of as the result of decision problems by households (e.g., Friedman, 1956, point 11; Friedman, 1963b, p. 10; Friedman and Schwartz, 1982, pp. 38, 40, 62). Friedman himself used “monetarism” and “monetarist” in his address at the University of London (1970a). He

¹²⁶ Anna Schwartz has suggested that another reason for Friedman’s reservations about the word “monetarism” is that “I think he attributed it to Karl Brunner, who was not really a master of English.” (Conversation with author, trip to Vermont Great Inflation conference, September 25, 2008.) Brunner is typically credited with the term monetarist or monetarism, but both terms predate Brunner’s usage of them (see Laidler, 2001; and the *Oxford English Dictionary*, 1976 and online editions).

¹²⁷ Friedman (1972d, p. 12).

¹²⁸ Friedman speaking in *The Guardian*, September 16, 1974.

became accustomed to using these terms readily and without prompting, including in correspondence and conversation.

On some occasions Friedman also associated the older quantity theory with a further retrograde aspect, namely the assumption of price flexibility, or, more fairly, of not having a firm description of the adjustment process of prices to money (e.g., Friedman and Schwartz, 1982, p. 44). But he generally qualified this case by describing it as the “simple quantity theory” (e.g. Friedman and Schwartz, 1982, pp. 59, 398). Further consideration by Friedman during the 1970s of the quantity-theory literature had the effect of leading him, if anything, to attribute more to the older writers. In particular, Friedman was struck by how explicit David Hume’s writings had been on the role of expectations: “David Hume has a statement somewhere about the fact that an increase in the quantity of money stimulates economic activity only so long as it keeps on increasing and people don’t expect it.” (*The Times*, September 13, 1976). Friedman decided that while he, and Lucas and Sargent after him, had expressed the point more formally, the expectational Phillips curve idea was due to Hume (Friedman, 1975a). While Patinkin (1972b) claimed that Hume did not believe in a long-run vertical Phillips curve, the explicit quotations given in Friedman (1975a) support the crediting of this idea to Hume, and Friedman’s interpretation was more recently reaffirmed by Mankiw (2001) in his study of the same Hume passages.

Friedman further credited Hume with the demand-for-money conception of the quantity theory that Friedman had used (Friedman and Schwartz, 1982, p. 621). So whereas Friedman (1968c, p. 433) attributed to Hume the “broad outlines of the quantity theory,” by the early 1980s he was crediting Hume with both the aggregate demand and aggregate supply aspects of his own framework and so, he said, Hume was the true originator of monetarism. Appropriately enough, it was on British television that Friedman said: “I really would like to make clear that the doctrines I proclaim are not original with me by any means, in fact if I have to find a source for them they are [from] David Hume.”¹²⁹

In their interventions in the U.K. debate, Samuelson and Solow argued that monetarism was not making valid points about monetary relations that U.S. Keynesianism had not

¹²⁹ *Free to Choose*, BBC2 debate, March 22, 1980, p. 15 of transcript. Likewise, at a press conference in Wellington, New Zealand, in 1981, Friedman said, “What is called monetarism, the quantity theory of money, was developed by David Hume in the eighteenth century. It is not ‘my’ theory—I have no patent on it.” (*Evening Post*, April 27, 1981.)

long since incorporated. Samuelson, for example, said: “Money was, so to speak, ‘rediscovered’ in my country around 1950... When Professor Friedman formulates his system in generality... it coincides with the post-Keynesianism of the Tobin-Modigliani type.” But the record does not support the denial of Friedman’s contributions, nor Samuelson and Solow’s confidence that U.S. Keynesianism circa 1968 had incorporated the role for monetary policy adequately. As we have seen, Friedman’s emphasis on money predated 1950, and his elaboration of it incorporated a general transmission mechanism not covered in Keynesian work; in particular, more than one interest rate, and (in contrast to positions taken by Samuelson and Modigliani) a sensitivity of consumption (not merely investment) to interest rates.¹³⁰ Furthermore, Solow and Samuelson in both the 1960s and 1970s disputed Friedman’s expectational Phillips curve analysis, contesting both its long-run-vertical property and its exclusion of a systematic role for cost-push factors. In well-known lectures given in Manchester, for example, Solow (1969) argued that cost-push factors mattered greatly in both the United Kingdom and the United States, that demand factors did not matter at all for U.K. inflation, and that the U.S. Phillips curve was permanently nonvertical.

Some influence of the money supply debate was felt in what policymakers said: Chancellor of the Exchequer Roy Jenkins stated, “I attach the greatest importance to monetary policy” (*House of Commons Debates*, April 15, 1969, p. 1007), and *The Economist* (April 18, 1970) referred to the “new importance attached to monetary policy in Britain.” As noted above, however, the changes actually made in the macroeconomic policy framework were not truly in the direction Friedman wanted. Indeed, at the U.K. Treasury, skepticism prevailed from top to bottom about the attention being given to Friedman. At a junior level, Treasury economist Stephanie Edge spoke in favor of the power of fiscal policy and criticized Friedman’s findings to the contrary: “The idea that simple one-equation comparisons can reveal anything is one that should be vigorously attacked.” (Edge, 1967, p. 205.) At a senior level, Treasury advisor Alec Cairncross wrote in his diary of October 6, 1968, that “the English press (and especially *The Times*) was making such a fool of itself over Milton Friedman” (in Cairncross, 1997, p. 327).

Cairncross’ reference to *The Times* concerned the articles being written by its economics editor, Peter Jay. Jay was initially regarded with suspicion on each side of the money

¹³⁰ See Blinder (1986) and Modigliani (1986) for characterizations of the pre-monetarist Keynesian view as one that denied the interest-sensitivity of consumption.

supply debate as a sympathizer with the other side. But further articles by Jay brought him out as a supporter of the monetarist arguments, and Jay later identified himself among “those... who began to advocate proper control of the money supply from the late 1960s” (*The Independent*, September 23, 1991). Friedman and Jay became good friends, appearing together on several episodes of both the U.S. and U.K. versions of the *Free to Choose* television program in 1980. In one of these programs, Friedman said that he and Jay “are in almost complete agreement on the desirable monetary policy.”¹³¹

Another journalist, Samuel Brittan, serves as an illustration of Friedman’s observation that “accidents play an enormous role in mankind’s experience.”¹³² Friedman happened to be visiting Cambridge University while Brittan was an undergraduate student there, and Brittan happened to have Friedman assigned to him as his tutor. Brittan joined the *Financial Times* after graduation. From his earliest writings, Brittan showed some indication of his training from Friedman, for example in his criticisms of price controls (*Financial Times*, October 1, 1956). But Friedman’s emphasis on monetary policy had little parallel in Brittan’s work until the late 1960s, whereupon Brittan became recognizably monetarist in outlook. Brittan considered the arrival of monetarism the “most interesting event for a very long time in the realm of economic ideas.” (*Financial Times*, January 8, 1970.) A long article by Brittan, headed “MONEY SUPPLY: The Great Debate” in enormous font, appeared in the October 25, 1968, edition of the *Financial Times*, discussing Friedman’s views and covering his American Economic Association presidential address (Friedman, 1968b). Brittan and David Laidler, who had been a Ph.D. student of Friedman’s at Chicago and from the late 1960s was at Manchester University, became two leading voices of monetarism in the United Kingdom during the 1970s. Cobham (1984) notes that although Laidler departed for Canada in 1975, he remained prominent in the U.K. debate during the second half of the 1970s. Neither Brittan nor Laidler was an echo chamber for Friedman, and both disagreed with him in print, but they both had firsthand knowledge of his positions. As Friedman observed, “You have the interesting phenomenon that whereas David Laidler came to Chicago, Chicago came to Sam Brittan.”¹³³

Alan Walters, an academic and financial consultant who had been undertaking U.K. analogues of some of Friedman’s empirical work since the early 1960s, wrote to

¹³¹ *Free to Choose*, PBS debate, Episode 3, pp. 16–17 of pdf transcript.

¹³² April 16, 1996, talk by Friedman at Claremont College (broadcast CSPAN, December 26, 1996).

¹³³ Friedman, speaking in September 1974, in *Institute of Economic Affairs* (1974, p. 102).

Friedman at the end of the decade to let him know that he was close to being a household name in the United Kingdom.¹³⁴ Shortly afterwards, Friedman's name recognition was confirmed by *The Guardian's* choice of headline, "Help to Stop Friedmanism." (November 19, 1969.) The writer of the article, Anthony Harris, was not sympathetic at all to Friedman's diagnosis of inflation, and asserted, "There is simply no statistical connection between the rate of growth of the money supply and the rate of inflation in Britain." This was the sort of hardline position that Friedman thought had disappeared from economics discussions, but which he would discover for himself was alive and well in the United Kingdom.

THE BEGINNING OF *MONETARY TRENDS*

In November 1966, Friedman and Anna Schwartz completed a draft of their manuscript on monetary trends (Figure 7), concerned solely with U.S. data, and submitted it to the NBER review process. Geoffrey Moore wrote in a memorandum to the reviewers Phillip Cagan, Solomon Fabricant, and Jack Guttentag, "Milton Friedman and Anna Schwartz have submitted the attached manuscript, *Trends in Money, Income, and Prices, 1867–1966*, for review by a staff reading committee. The report is a proposed sequel to their monetary history. I should be grateful if you would agree to be a member of this committee..."¹³⁵

One of the reviewers, Jack Guttentag, did not return with a written report, while Fabricant had little to say on the monetary issues raised by Friedman and Schwartz. The lack of feedback from these quarters was, however, more than compensated for by the quality of the remaining review. The masterly assessment by Phillip Cagan began with the sentence: "People who go from the *Monetary History* to this are in for a shock."¹³⁶ In addition to providing detailed comments, Cagan urged the authors to "slow down the pace, and help the reader see where he's been, where he's at, and where he's going."

Cagan cautioned against a statement in Friedman and Schwartz's manuscript that, compared to Irving Fisher, they had at their disposal "more powerful statistical methods

¹³⁴ Letter from Alan Walters to Milton Friedman, December 4, 1969, Friedman office correspondence (uncatalogued as of end-2007).

¹³⁵ Memorandum, NBER, December 2, 1966; courtesy Anna Schwartz.

¹³⁶ Phillip Cagan, "Comments on the Friedman-Schwartz Manuscript, *Trends in Money, Income, and Prices, 1867–1966*," January 23, 1967; courtesy Anna Schwartz.



Figure 5. David Laidler, September 2003.
(Photograph taken by author.)



Figure 6. Anna J. Schwartz, at NBER New York office, December 2008.
(Photograph taken by author.)



Figure 7. November 1966 Friedman-Schwartz *Trends* draft.
(Federal Reserve Bank of St. Louis collection.)

and... the aid of modern computers.”¹³⁷ “Whatever you have done that Fisher didn’t do,” Cagan wrote, “computers didn’t make that much difference. He carried out rather extensive computations.” Friedman and Schwartz deleted this passage and their revision made no claim about the modern nature of their statistical procedures, a most wise change in light of later developments.

Friedman (1955, p. 30) had written about the desirability of studying U.K. monetary data, and, somewhere along the line, Friedman and Schwartz elected to cover U.K. data in the revised version of their *Trends* manuscript, although it was not a change specifically requested in the written reviews. A major obstacle, the construction of historical data, was partly overcome when David Sheppard, a Harvard Ph.D. graduate shortly to return to the United Kingdom, contacted Friedman to let him know of his work in the area. In his reply to Sheppard, Friedman indicated that U.K. data were being incorporated into his new volume with Schwartz.¹³⁸ He and Schwartz thereafter used the Sheppard data on money. Anna Schwartz used the data in a 1969 paper for U.K. audiences (Schwartz, 1969), and Friedman referred fleetingly to the *Trends* project during Congressional testimony in October 1969, where he said he had been “working on some British data which go back a century. They show the same relation [as in the United States].”¹³⁹

¹³⁷ Friedman and Schwartz (1966, p. 2–191).

¹³⁸ Friedman, letter to David K. Sheppard, July 10, 1967, Friedman office files (uncatalogued as of end-2007).

¹³⁹ October 6, 1969, testimony, in Joint Economic Committee (1970a, p. 826).

Considering this energetic start in the late 1960s, Friedman and Schwartz surely could not have imagined that *Monetary Trends* would not be finished until the early 1980s.

STARVE THE BEAST

“I do not believe that the level of federal spending or appropriations is independent of the level of tax receipts. In fact, I believe that the only effective method of cutting down government spending is by cutting taxes.” In this portion of his October 6, 1969, Congressional testimony (in Joint Economic Committee, 1970a, p. 828), Friedman succinctly gave both the positive and normative economic content of what has come to be known as the “starve the beast” position on the source of growth in government. It was a position that Friedman had begun advocating in the early or mid-1960s, possibly influenced by some applications of the argument to the growth of government in the United Kingdom.

Romer and Romer (2007) cite a 1967 *Newsweek* column by Friedman (August 7, 1967) as his earliest use of the starve-the-beast argument. But the argument had already been attributed to Friedman in the London press on the basis of a talk Friedman gave in Chicago on November 22, 1966 (reported in *Chicago Sun-Times*, November 23, 1966). In that talk, Friedman had said that he “strongly opposed” a tax increase. “Postwar experience has shown that Congress will spend whatever the tax system will raise, plus a little more. Hence, I believe a tax rise would simply foster a higher level of government spending.” (*The Banker*, January 1967.) *Financial Times* writer Harold Wincott quoted this statement by Friedman in his column (January 3, 1967). Wincott’s column referred to Friedman as a “famous man” and *The Banker* introduced its excerpt from Friedman’s talk by describing him as “the well-known Professor of Economics in the University of Chicago”; both descriptions reflected Friedman’s rising profile on both sides of the Atlantic.

An intriguing observation in an article published in late 1967 by the junior U.K. Treasury economist, Stephanie Edge, provides further indication that Friedman had used the starve-the-beast argument for some years. Edge (1967, pp. 202–203) said it was “*well known* that Friedman thinks that government expenditure is, to some degree, a positive function of tax revenue” (emphasis added). In this connection, Edge cited Friedman and Meiselman (1964, p. 375), who had said in a footnote that “since World War II... Congress seemed willing to spend whatever the tax system would raise plus a little

more.” Friedman and Meiselman went on to cite Lewis (1964, p. 250) for evidence on this point. The year 1964 does appear to be the earliest point at which Friedman made the argument in print, not only in his article with Meiselman but also in a piece for the *New York Times Magazine* (October 11, 1964). Friedman may have used the argument earlier in the 1960s, however, as Paul Samuelson referred in an October 8, 1962, *Financial Times* column to “the group who want to cut taxes in the hope that this will put pressure on the government to cut its expenditure.”

Although neither Lewis nor Friedman-Meiselman cited it in their 1964 articles, the starve-the-beast argument had been made at length by a U.S.-based British humorist and commentator, C. Northcote Parkinson. Parkinson (1960) had offered “Parkinson’s Second Law” the regularity that “expenditure rises to meet income,” and attributed the twentieth-century increase in U.K. government spending to the growth in tax revenue. Both Friedman and Meiselman later acknowledged Parkinson’s Second Law. For example, the March 1971 issue of the U.K. magazine *Management Today* reported, “The fiscal theory of the monetarists has prompted Meiselman to propound ‘Parkinson’s Law of the Fisc.’ This semi-serious law holds that the level of government spending rises to meet the available revenue.”¹⁴⁰ Friedman mentioned and quoted Parkinson (1960) in his *Newsweek* columns (e.g., July 12, 1976). He also stated: “I believe along with Parkinson that government will spend whatever the tax system will raise plus a great deal more.” (Friedman, 1978b, reprinted in Friedman, 1978c, p. 19).

During a London appearance, Friedman (1974b) argued that taxes drove government spending in the United Kingdom, and urged a tax cut to encourage reductions in government spending. In contrast to the United States, where Ronald Reagan endorsed the starve-the-beast argument, policymakers in the United Kingdom of both parties have not been converted. Successive government leaders have rejected starve-the-beast, both as positive economics—they have talked as though government spending drives taxes—and as normative economics—they have spoken of government spending restraint as a precondition for tax cuts rather than the other way around. An early rejection came from Winston Churchill, who as Chancellor of the Exchequer had said “we have not reduced expenditure, and consequently taxation.” (*The Times*, February 4, 1928.) A succession of more recent policymakers have echoed the rejection:

¹⁴⁰ An example of the statements by Meiselman that the article was referring to was his Congressional testimony of October 13, 1969, in which Meiselman referred to “the dilemmas posed by a Parkinson’s Law of the Fisc that expenditures always rise to meet receipts.” (In Joint Economic Committee, 1970b, p. 153.)

Anthony Barber (Chancellor of the Exchequer, 1970–74): “[T]he Labour Government nevertheless continued to increase public expenditure and, as a result, they had to put up taxation.” (*House of Commons Debates*, November 4, 1970, page 1118.)

Edward Heath (Prime Minister, 1970–74): “I’m afraid there is [a] part of our party that has an absolute mania for tax cuts.” (*Yorkshire Post*, October 10, 1995.)

Denis Healey (Chancellor of the Exchequer, 1974–79): “All this has to be paid for, and I told you in the last conference in Blackpool that it has got to be paid for by taxes.” (In *Labour Party*, 1974, p. 283.)

James Callaghan (Prime Minister, 1976–79): “There will be, I trust, some rewards for middle management. There will be some recognition of the burden of taxation. Part of the cuts in public expenditure that we have made at great pain and cost will enable the Chancellor to do that.” (*Evening Post*, March 29, 1977.)

Margaret Thatcher (Prime Minister, 1979–90): “When I was not able to get public spending down as low as I wished, I took the view that if we were going to spend that amount of money, we must cover it honestly—by taxation.” (*The Sun*, September 30, 1983.)

John Major (Prime Minister, 1990–97): “We had to raise revenue in order to protect services. Raising revenue means raising taxes.” (BBC1, October 25, 1999.)

Kenneth Clarke (Chancellor of the Exchequer, 1993–97): “As I’ve always said, tax cuts will only come if they fit in with the policy of reducing borrowing.” (*Yorkshire Post*, July 27, 1996.)

Gordon Brown (Chancellor of the Exchequer 1997–2007): “The Government are prepared to make the necessary investment and, in the case of the national health service, ask people to pay a higher rate of national insurance so that we can do so.” (*House of Commons Debates*, December 10, 2003, p. 1084.)

PERSONALITIES, 1959–1970

HARRY JOHNSON

During a 1994 visit to Australia, Friedman met with a journalist who had been a student of Professor Harry Johnson at the London School of Economics in the 1960s. After his meeting with Friedman, the journalist reported that they had discussed “the late Harry Johnson, whom Friedman remembers with affection as his chief disciple.” (*Sydney Morning Herald*, November 24, 1994.) It is easy to imagine Friedman reacting in the manner described, but probably not for the reason the journalist implied. Friedman probably felt warmer about the idea that Johnson was remembered as a follower of Friedman, than he did about the idea of remembering Johnson. Although Johnson was sometimes perceived as a surrogate for Friedman in the Keynesian-monetarist debates taking place in the United Kingdom, the two did not get on well.

Friedman observed in 1992, “I’ve had no difficulty in combining perfectly friendly relations with people on a personal level, with intellectual disagreements... There are very few people with whom I’ve had any difficulty getting along with.”¹⁴¹ Among the very few was Leon Keyserling, former Chairman of the Council of the Economic Advisers, whom Friedman publicly described as “a notorious lawyer turned economist” (*Milton Friedman Speaks*, Episode 4, p. 13 of transcript), “an unreconstructed collectivist” (Friedman, 1982c, p. ix), “a rather unpleasant character” (Friedman and Friedman, 1998, p. 343), and “a bastard” (*California*, October 1984). Another of the few was Johnson. Johnson’s joined the University of Chicago in 1960 (becoming part-time from 1966, when he began his London School of Economics affiliation), a move which gave Friedman and Johnson the opportunity to find out just how much they disliked each other. The fact that Johnson was increasingly shifting from the field of trade theory to Friedman’s field of monetary economics raised the scope for confrontation.

The falling-out between them began almost at once, apparently developing from a disagreement over the properties of floating exchange rates (Bhagwati, 1977, pp. 224–225). During the 1960s, their animosity generally did not go public, although Friedman (1966, pp. 75, 82) did say that he thought Johnson’s statements about monetary/real interactions were “either seriously incomplete or flatly wrong” and that

¹⁴¹ Milton Friedman, interview with author, Stanford University, January 22, 1992.

Johnson's characterization of the contribution of the *General Theory* gave "a misleading interpretation of the history of thought." A further hint of their acrimonious relations came in 1969, when Friedman described Johnson as "my colleague Harry Johnson whom I know very well" (Friedman, 1969c, p. 109). The significance of this choice of words is brought out by the contrast with Friedman's descriptions of other colleagues: in 1975 Friedman referred to "my good friend and colleague Bob Eisner" (Joint Economic Committee, 1976, p. 46) and Bordo and Friedman (1987, p. xii) referred to Anna Schwartz as their "friend and colleague."

For his part, Johnson repeatedly found fault with Friedman's citation practice, writing style, and description of the literature; Moggridge (2008) and Leeson (2000) provide examples of Johnson's criticisms, while Leeson gives excerpts from correspondence in which Johnson referred to Friedman as "a crook." The tension between Friedman and Johnson went completely into the open in 1971 when Johnson (1971b) argued that Friedman was simply repackaging Keynesianism under a different name.

The arguments Johnson advanced to support this contention do not stand up very well. For example, he maintained (building on his own argument along these lines in Johnson, 1962, and that of Patinkin, 1969) that Friedman's (1956) money demand function was just a Keynesian demand-for-money function. But, as we have seen, Friedman's approach was distinct from Keynes (1936) in having a vector of interest rates as the opportunity cost variable, in abandoning the concept of idle money, and in ruling out the liquidity-trap case. Johnson (1971b) claimed that well-behaved money demand is a Keynesian concept because it is built into IS-LM analysis. But Hicks (1937) developed IS-LM to integrate the Keynesian and non-Keynesian cases, and associated the *General Theory* with the special case of IS-LM where money demand is not well-behaved, i.e., the liquidity trap. This was the case that Friedman associated with the *General Theory* too. Johnson's attempt to deny the association between the liquidity trap and the *General Theory* sometimes went to extremes, as when Frenkel and Johnson (1977) asserted that the liquidity-trap case was nowhere to be found in Keynes' writings.

In blurring the distinction between Friedman's framework and Keynesianism, Johnson also overlooked Friedman's emphasis (in Friedman, 1956, and numerous other writings) on the price level and inflation as endogenous variables and on monetary policy as the instrument that determined them. His overlooking this contribution in his (1971b) paper

was despite the fact that Johnson (1971a) acknowledged the absence of a theory of the price level in much Keynesian analysis.

Johnson (1971b) also claimed that Friedman's theory of the consumption function was just the Keynesian theory of the consumption function with "wealth" relabeled "permanent income." Friedman actually did not have a problem with the notion that "wealth" and "permanent income" were synonymous, and used the terms interchangeably himself.¹⁴² But Friedman's *concept* of wealth was innovative, via its explicit appeal to a possibly infinite-horizon agent who included their stream of expected future income in the calculation of permanent income. It is precisely on this issue that Johnson missed the boat, for Johnson (1971a) argued that the fact that Friedman's agent could be infinite-horizon made the theory much less interesting than other consumption theories. The onset of rational expectations, infinite-horizon models from the 1970s, in part building on Friedman (1957a), was a development that put Johnson's criticism into obsolescence. For that matter, Johnson was slow to appreciate several important developments in monetary economics in the 1960s and 1970s, initially doubting the natural rate hypothesis, endorsing flawed econometric evidence against the hypothesis (see Laidler, 1984; Kenen, 1985), and arguing that rational expectations was not an important advance in the literature (Johnson, 1975).

Friedman wrote to Anna Schwartz after Johnson delivered his 1971 criticisms that Johnson was in a quandary: the fact that he and Friedman did not get on well meant that he wanted to blast Friedman in print, but over the years Johnson had converged so much to Friedman's positions that he had little to offer in terms of concrete economic disagreements.¹⁴³ Friedman's remarks here alluded to a perception of Johnson that Johnson was known to resent. Both Leeson (2000) and Moggridge (2008) emphasize that Johnson disliked being classed as monetarist or as a surrogate for Friedman. A latter-day manifestation of this resentment was in Johnson's remark, during a 1975 conference in Helsinki, where Johnson said, "It's not my usual fashion to run around trying to quote Milton Friedman." (In Roundtable, 1975, p. 33.)

But there was substance to the classification of Johnson as a Friedman follower. Despite their personal animosity, Johnson had indeed, as Friedman said, come round to

¹⁴² E.g., Friedman and Schwartz (1982, p. 258); and in *Wall Street Journal*, April 26, 1984.

¹⁴³ Friedman, letter to Anna Schwartz, February 6, 1971. The Hoover Archives' copy of this letter is in Box 91, folder 7, of the Friedman papers.

Friedman's positions on key economic issues. Johnson accepted Friedman's natural rate hypothesis after his initial resistance; he also accepted other aspects of the monetarist analysis of inflation. "The monetarists don't have a simple model," Johnson said at the 1975 conference, "they have truth. But anyhow, I am not anxious to discuss that particularly..." (Johnson, 1975, p. 14.)

Johnson's own contributions to monetary economics (as opposed to trade theory) are hard to pin down.¹⁴⁴ A paper he wrote on "The Case for Floating Exchange Rates, 1969" was clearly an attempt to improve on Friedman's (1953b) arguments. But the supposed improvement took the following form: whereas Friedman had said a floating rate let a country have an inflation rate of its choice, Johnson suggested that a float allowed a country to pick its preferred inflation/unemployment combination. Johnson advanced this argument just as the natural rate hypothesis was sweeping the profession, and within a few years Johnson would discard his 1969 argument himself.

Another aspect of Johnson's image alluded to in Friedman's letter was that he was perceived as a monetarist in the United Kingdom but as a Keynesian critic of Friedman in the United States. Anna Schwartz recently recalled, "MF often joked about Harry Johnson the Keynesian in the U.S. and monetarist in the U.K."¹⁴⁵ This was not just a monetarist criticism of Johnson. For example, Paul Samuelson (1984, p. 8) also observed that Johnson "had a stochastic position on monetarism—some months he castigated it, some months he defended it."

Johnson's perceived inconsistency had its plus side. As an advocate of the monetarist position outside the United States, he often took on many of the harder-line Keynesians found in the United Kingdom and Canada. In the United Kingdom Johnson debated Sir John Hicks, with Johnson (1976) arguing the case for "What Is Right With Monetarism"; in Canada, Johnson gave testimony to a senate committee and tried to undo some of the damage created by prior testimony by Sir Roy Harrod. This session featured some of Johnson's finest and most durable statements, including the statement that the Canadian government could deliver price stability if it "said it would provide the fiscal and monetary framework for 2 to 3% inflation." At the same session, Johnson said, "I don't

¹⁴⁴ Alvin Marty, who worked with both Friedman and Johnson as a visiting faculty member at the University of Chicago, made this point in an interview with the author on December 5, 2008.

¹⁴⁵ Anna Schwartz, email to author, March 18, 2009.

mention cost-push inflation because I don't believe in it." (*Toronto Daily Star*, May 27, 1971.)

Speaking on the talk show *Dinah!* several weeks before Johnson's death, Friedman said, "I think the true test of any scholar's work is not what his contemporaries say, but what happens to his work in the next 25 or 50 years, and the thing that I will really be proud of is if some of the work I have done is still being cited in the textbooks long after I'm gone. I say I'll be proud of it—I don't know if it'll be in the next world, not in this." (*Dinah!*, March 30, 1977.) As things turned out, Friedman lived to see the 25-year-ahead world he had speculated about in 1977, and was gratified to find his name and concepts permeating the textbooks and the monetary policy literature. The fate of Harry Johnson's work was different. Johnson saturated the monetary economics literature with publications during his lifetime, but by 2002 bibliographical citations, and even name recognition, of Johnson had practically dried up.

On April 9, 1979, Friedman gave the Harry G. Johnson Memorial Lecture at the Royal Society in London. Friedman opened his lecture with the words, "Harry G. Johnson's main field of professional interest was international trade." (Friedman, 1980b, p. 497.) That opening statement perhaps indicated what Friedman thought of the scores of articles Johnson had published in the field of monetary economics.

ENOCH POWELL

In the 1950s and 1960s, Enoch Powell was a Conservative politician known for taking free-market positions. Another economic position on which Powell became identified from 1957 was the advocacy of the use of monetary policy against inflation, as he was a member of the Treasury ministerial team when the Macmillan Government raised Bank Rate to 7% to September 1957. Powell resigned along with Chancellor of the Exchequer Thorneycroft and another Treasury minister in January 1958, in a dispute over government spending cuts. Friedman knew Powell through the Mont Pelerin Society and approved of Powell's outspoken advocacy of smaller government and of a floating exchange rate. In this connection, Friedman wrote in 1967 that U.K. economic problems required "a new approach which only Enoch Powell seems to appreciate." (*Sunday Telegraph*, June 25, 1967.)

Powell became far more famous—and notorious—in 1968 when he spoke critically of immigration patterns in the United Kingdom, claiming they would lead to civil war. As many have noted (e.g., Cockett, 1994, p. 167), Powell’s new image had a detrimental effect on the advocacy of economic liberalization in the United Kingdom because of the presumption it created that there was a natural connection between free-market economics and extreme views on immigration control, Powell having associated himself with both.

Friedman (1962a) devoted a chapter of *Capitalism and Freedom* to “Capitalism and Discrimination.” There he had said, “I believe strongly that the color of a man’s skin or the religion of his parents is, by itself, no reason to treat him differently... I deplore what seem to me the prejudice and narrowness of those whose tastes differ from mine in this respect and I think the less of them for it.”¹⁴⁶ In an appearance on *Donahue* in 1979, Friedman added that the United States “did not become great by preventing people from coming here from abroad and buying land and setting up businesses. Quite the other way around.”¹⁴⁷

In light of these observations, it might be expected that Powell’s immigration views would cause a permanent rift between Powell and Friedman. That rift duly took place, and the only reference to Powell in Friedman and Friedman (1998, p. 335) is Rose Friedman’s description of him behaving like “a madman” and voicing intolerance at a Mont Pelerin meeting in 1972. But the Friedman-Powell rift was drawn out over the 1970s, not concentrated in 1972.

In an October 1968 memorandum to President-Elect Nixon, Friedman referred to Powell’s economic views, again noting Powell’s support for a sterling float and contrasting it with the leadership of both major U.K. political parties (see Friedman, 1988, p. 438). Friedman and Powell corresponded sporadically over 1972–74, sticking to economics subjects. There are signs of tension in the later correspondence, with Friedman saying he hoped that he and Powell were on good enough terms to communicate directly, and Powell citing the imminence of another election as why he would probably not see Friedman during Friedman’s forthcoming U.K. visit.¹⁴⁸

¹⁴⁶ Friedman (1962a, p. 111).

¹⁴⁷ *Donahue*, September 6, 1979 (Chicago broadcast date; the syndication broadcast date was October 10, 1979).

¹⁴⁸ Friedman letter of August 6, 1974, to Powell, and Powell reply to Friedman of August 26, 1974 (Friedman office correspondence files, uncatalogued as of end-2007).

Though acknowledging Friedman's advocacy of a floating exchange rate (*The Spectator*, August 28, 1971), Powell was sparse in his public acknowledgements of Friedman's work on money. U.K. politicians often tend to downplay any debt to academics in shaping their economic thinking, but Powell went further: he came to resent the attention given to Friedman and even took the position that he, Powell, should be credited with launching monetarism. Since Powell's public adoption of monetarist ideas dated from 1957, well after Friedman's framework was on record, Powell's claim had no merit as a matter of chronology. It is, furthermore, hard to accept that Powell's development of monetarist themes occurred independently of Friedman's work. There was a straightforward link between Friedman's research and Powell's emphasis on the money supply. When Powell and Thorneycroft emphasized the money supply while at the Treasury in 1957, it had been partly on the advice of Lionel Robbins—Thorneycroft said that Robbins “has guided me for so long, and I set such store by his comments on the economic scene”¹⁴⁹—and, as we have seen, Robbins acknowledged Friedman as a key figure in reviving the quantity theory and as an influence on himself.

Powell's resentment was evident in his 1980 statement of resignation from the Mont Pelerin society, in which Powell said the society was a “Hayek adulation society, with a minor niche for Friedman.”¹⁵⁰ But Powell went further in a 1981 television interview (excerpted in *The Listener*, May 28, 1981). There he said of himself and his 1957 Treasury colleagues: “Of course, we didn't know how distinguished we were. We didn't know that others were to get the Nobel Prize and not share it with us for the monetarist theory.” The person interviewing Powell on this occasion was Robert McKenzie, who had interviewed Friedman on radio in 1971, moderated the U.S. version of Friedman's *Free to Choose* program in 1980, and also overlapped for many years with Lionel Robbins at the London School of Economics. He therefore was in a good position to know of the Friedman-Robbins influences on Powell, and surely was taken aback by Powell's claim.

Powell's grasp of the details of “the monetarist theory” was in any case shaky, notwithstanding Friedman's description of Powell (in the memorandum to President-Elect Nixon) as “brilliant.” In particular, Powell repeatedly suggested that, in a floating-rate regime, excessive money growth could *only* come from budget deficits. This

¹⁴⁹ *House of Lords Debates*, November 17, 1970, page 989.

¹⁵⁰ Quoted in Heffer (1998, p. 645).

contrasted with Friedman's stress¹⁵¹ on the fact that deficits could be financed without money creation; and on his explicit acknowledgement that excessive money growth could result from the financing of private spending.¹⁵² In a letter to *The Times* (August 29, 1973), Friedman attempted to reconcile Powell's and his own positions on the relation between money growth and deficits. But Friedman subsequently seems to have decided that he and Powell were indeed far apart, on economic and political issues alike.

5. 1970–1979

EVENTS, 1970–1979

The Conservative Party, led by Edward Heath, won the U.K. general election of June 1970. Friedman had not met Heath (*The Listener*, February 11, 1971), and did not do so until 1974. There is nevertheless evidence of an influence of Friedman's writings on Heath's statements. Heath's introduction to his 1970 party platform said, "once a policy is established, the Prime Minister and his colleagues should have the courage to stick to it. Nothing has done Britain more harm in the world than the endless backing and filling which we have seen in recent years." (*The Guardian*, May 27, 1970.) It is possible that the drafting of this passage was influenced by Friedman and Schwartz's (1963, p. 289) characterization of the Federal Reserve's history as one of "so much backing and filling, so much confusion about purpose..."

There was less indication that the new Government would be influenced by the Friedman-Schwartz work when it came to monetary policy formulation, as Anna Schwartz discovered on a visit to the United Kingdom very soon after the election result. Writing to Friedman about her meetings with U.K. academic economists and Bank of England officials, Schwartz reported: "Much talk generally of what difference the Conservative Government would make for monetary policy... [The Bank officials] didn't see that it would make any difference. Apparently, Bank policy is perfect."¹⁵³

On the matter of the government's role in the market, the prospect of U.K. economic policy going more in a direction favored by Friedman seemed to be better. Friedman said

¹⁵¹ E.g., in Friedman (1970a, 1974a).

¹⁵² E.g., in his appearance on BBC2, September 23, 1974.

¹⁵³ July 2, 1970, letter from Anna Schwartz to Friedman. The Hoover Archives' copy of this letter is in Box 91, folder 7, of the Friedman papers.

in 1971, “My own personal view is that... the most effective road to development is through free enterprise and private investment, and that the government can serve best by limiting itself to essential government functions...”¹⁵⁴ In the same year, the Heath Government objectives were laid out by the Chancellor of the Exchequer, Tony Barber, in a form that seemed in keeping with Friedman’s views: “Our object is to lessen government interference and reduce government subsidies; to extend the opportunities for profitable enterprise; to widen the area within which industry rather than government will make decisions.” (*Dallas Morning News*, February 9, 1971.) Some of the Government’s measures during 1970 and 1971 did go in this direction, and a UPI report’s assessment was that “‘Ted’ Heath—as he is known to everybody—has set about revolutionizing Britain... He has begun dismantling Socialist controls over most aspects of the nation’s life...” (*Philadelphia Bulletin*, June 7, 1971.) Friedman himself expressed cautious approval, observing that the United Kingdom had “potential, but only if you could by some miracle get rid of the enormous mass of controls, interventions, welfare-state measures and so on... Heath has been moving somewhat in that direction.” (*Vision*, April 1972.)

In fact, a better, if unwitting, indication of the direction ultimately taken by the Heath Government was provided in a political commentator’s observation in 1970 that “Mr. Heath is determined to make his government the most Tory of all Conservative governments since the war...” (*South China Morning Post*, November 7, 1970.) The commentator surely meant to imply that Heath would take pro-free market and demand-restriction policies further than previous Conservative Governments. But on another interpretation, to be the “most Tory” of all the postwar governments could mean expanding the role of government and extending the use of expansionary Keynesian measures, as the prior Conservative governments had done. That was Friedman’s interpretation of Tory governments: he thought that the “Tory Party has never been a party of free trade and free markets” (BBC2, March 12, 1983), and that both Labour and Conservative Party governments from 1945 to 1979 had followed “socialist policies.”¹⁵⁵ In the debate portion of the U.S. version of the *Free to Choose* series (Episode 5), the other debate participants challenge Friedman’s characterization of historical Conservative Party policy. But his interpretation has been supported by statements of some notable U.K. figures: Nigel Lawson, for example, wrote that “the Tory party draws its inspiration

¹⁵⁴ Friedman (1971a, p. 847).

¹⁵⁵ Friedman and Friedman (1980, p. 330 of U.K. paperback edition; p. 283 of scanned U.S. edition on google books).

and purpose largely from outside the economic field” (*The Spectator*, February 17, 1967), and Labour politician Peter Shore noted that no party had increased the power of the state more than the Conservative Party (*House of Commons Debates*, November 1, 1967, p. 293). Likewise, the *Yorkshire Post* (May 1, 1957) editorialized about the postwar period that “recent Conservative Governments have done much to build up and strengthen the Welfare State.”

The Heath Government moved away from free-market policies during 1971, and made the break more explicit with the passage of the Industry Act 1972. The Act introduced extensive subsidies to private investment, contrary to Friedman’s dictum, “Capital investment that has to be subsidized is not worth having.” (*Wall Street Journal*, February 12, 1997.)

The change in direction was felt also in the Heath Government’s policies against inflation. The Government started cutting the Bank Rate in April 1971. It had consistently seen inflation as a nonmonetary problem, and in November 1972 imposed wage-price controls. Andrew Alexander, a political commentator for the *Daily Mail*, joined the number of journalists criticizing the strategy from a monetarist perspective. Alexander noted the “calculations and records going back a century” by the “leading American economist, Professor Friedman.” “The Government,” continued Alexander, was “ignoring those economists who demand curbs on the money supply,” and instead was “hooked on printing money.” (*Daily Mail*, October 31, 1972.)

Alexander noted that the Government’s discussion of high inflation had largely taken the form of “blaming the unions.” Indeed, Heath had told the House of Commons in May 1971, “We have always said that inflationary wage increases are the cause of price increases. There can be no doubt about that.” (*House of Commons Debates*, May 18, 1971, p. 1077.) Similarly, Harold Wilson (back to being Opposition Leader after losing the 1970 election) said, “Of course higher wages without higher productivity are an important factor in price increases. We have always said that...” (*House of Commons Debates*, July 18, 1973, p. 505.) Friedman, by contrast, had said during his 1970 visit to the United Kingdom: “I do not believe that in Britain or any other country wage inflation is an independent factor producing inflation of prices.” (*Sunday Times*, September 20 1970.) In a BBC radio broadcast in May 1974, Friedman observed, “Right now in Britain the trade unions are being blamed for inflation. I have been defending them from that

charge.”¹⁵⁶ After his visit to the United Kingdom later in 1974, Friedman expressed concern that “everybody from left to right is making the trade unions the scapegoat” for inflation (Friedman, 1975d, p. 20).

Meanwhile, over 1971–73, the Bretton Woods system was collapsing, despite what Friedman said was officials’ belief that “they can put Humpty Dumpty together again.”¹⁵⁷ The London *Evening Standard*’s financial columnist blamed the foreign exchange market turmoil on the “incredible influence of economist Milton Friedman,” charging that Friedman’s theories had discouraged international coordination of policies (May 5, 1971). Though he would surely have liked to accept the credit for the advent of floating rates, Friedman concluded that his advocacy of flexible rates had had “absolutely no effect,” and that it was instead the “brute force of events” that had forced governments to realize that fixed exchange rates were untenable (*The Listener*, April 27, 1978). The pound sterling began floating in June 1972.

In early December 1972, Friedman learned that a debate had been taking place in the London *Times* about his 1967 American Economic Association presidential address. His statement there (Friedman, 1968b, p. 11), that “full adjustment” to a shift in the inflation rate takes “a couple of decades,” had been interpreted by one critic as implying that removing inflation would take 20 years of above-normal unemployment. Friedman wrote a letter to *The Times* to clarify that by full adjustment he meant re-settling at the steady state. “The important point is that while ‘full’ adjustment may well last several decades, the period of unusually high unemployment is far shorter, more like two to five years.” Friedman’s letter was dated December 6 and published in *The Times* on December 12.

Around the same time, in a submission to Congress’ Joint Economic Committee, Friedman had occasion to convey his opinion of the U.K./France Concorde project. That project had reached fruition partly from the injection of funds from the U.K. government. The result was an air service that cut the length of intercontinental travel, but only for the elite class of customers who could afford the ultra-high ticket prices. Friedman (1958a) had criticized the involvement of the government sector in the creation of “monuments” that did not raise ordinary living standards, and his Congressional submission (dated December 11, 1972) urged that the United States government not follow the Concorde

¹⁵⁶ In Vaizey (1975, p. 70)

¹⁵⁷ September 23, 1971, testimony, in Joint Economic Committee (1971, p. 699).

precedent by subsidizing a U.S. Supersonic Transport (SST). “A governmental decision to produce an SST largely at its own expense is a step toward socialism and away from free enterprise.”¹⁵⁸

Though the preceding two items do not appear in his published bibliographies, they could easily have become the last things Friedman ever wrote for publication. On December 15, Friedman had open-heart surgery. The surgery was successful, and Friedman was discharged on December 26 (*Kansas City Times*, December 27, 1972), but Friedman lost considerable weight in the wake of the surgery, and his family medical history was inauspicious (“my father,” he later recounted to John Taylor, “had died when I was in high school.”)¹⁵⁹ As Anna Schwartz has observed, “Who would have thought at that time that Friedman would live on to ninety-four.”¹⁶⁰

From the United States, Friedman criticized U.K. monetary policy developments during 1973, observing in Congressional testimony that “defective as our policy has been, it has been less erratic, more moderate than the policy of most other leading countries.”¹⁶¹ He observed later in the year that Heath had gone from what Friedman perhaps too generously called a “tight money policy” to “a policy of stimulating... Now you have prices rising in Britain at a rate of something over 10% a year.” (Friedman, 1973b, p. 33.) The British magazine *Management Today* pondered Heath’s and Friedman’s diagnoses of the inflation problem in its August 1973 issue. “But is the entire phenomenon of unusually rapid and apparently ineradicable inflation new in itself?,” its editorial asked. “Is it a different variety, considerably more virulent, of the disease to which Western society has been susceptible for many decades past? The temptation, of course, is to say that it is: to blame union militancy... But economic historians half a century hence may well not be impressed by this argument. To them, the inflation will probably seem a classic case of monetary inflation, engendered by the usual process of overproduction of liquid currencies.”

The editorial just quoted was something of an outlier in the general U.K. discussion in 1973. The tendency to consider inflation to be nonmonetary in character intensified in the wake of the oil and other commodity price shocks of that year. Wherever he went

¹⁵⁸ In Joint Economic Committee (1973a, p. 81).

¹⁵⁹ In Taylor (2001, p. 110).

¹⁶⁰ Remarks of Anna Schwartz to author, New York office of NBER, May 27, 2008.

¹⁶¹ Friedman, June 21, 1973, testimony, in Joint Economic Committee (1973b, p. 120).

during the 1970s, Friedman found himself having to explain the fallacy inherent in special-factor explanations for inflation. “Arithmetic is one thing and economics is a very different thing,” was how Friedman put it in one appearance (*Meet the Press*, November 12 1978). “...The great confusion in this area is to confuse particular prices with prices in general.” In 1979 Friedman, perhaps near his wit’s end, reiterated: “OPEC does not cause inflation; no, sir.”¹⁶²

What Friedman (1975b, p. 137) called the United Kingdom’s “major economic crisis in early 1974,” with U.K. inflation passing 15%, culminated in an election which returned Harold Wilson to power. Friedman noted that the recent U.K. elections had helped refute the claim that governments do not lose elections because of high inflation. “Inflation surely helped to make Mr. Edward Heath Prime Minister in 1970,” Friedman (1974c, p. 44) observed, “and, even more surely, ex-Prime Minister in 1974.”

The change of government meant some continuity in policies, due to the bipartisan attitude on inflation control; as a *New Statesman* columnist observed (March 16, 1973), “Mr. Heath’s conversion to a prices and incomes policy means that both parties have now accepted this instrument for combating inflation.” One variation rung by the change of government was the form that price control took. Even before imposing nationwide compulsory price controls in 1972, the Heath Government had intervened in the pricing decisions of public enterprises, reflecting the tendency noted in Friedman (1970c, p. 21) for controls over utilities prices to be invoked as an anti-inflation measure. The new Wilson Government extended subsidies for prices to certain private sector goods. Friedman argued (*Newsweek*, November 14, 1977) that price subsidies meant that consumers effectively paid above the market price: they paid the subsidized price directly, plus the difference between the subsidized price and the free-market price by taxation, plus a premium equal to the cost of collecting the additional taxes needed to pay for the subsidies. Fortunately, the price-subsidization scheme was largely abandoned by the Wilson Government in 1975.

The centerpiece of the Wilson Government’s incomes policies measures was, however, intended to be its “Social Contract” agreement with the unions. Friedman said that “the so-called Social Contract... gives people a false impression of both the causes of inflation and the way to cure it.” (BBC2, November 9, 1976.) The Social Contract would do “no

¹⁶² May 17, 1979, testimony, in Committee on the Judiciary (1980, p. 154.)

good whatsoever as long as they continue to run the printing press” (Friedman, 1975d, p. 20); and, if money growth was slowed, the Social Contract would be seen as having been successful, even though the reduction in inflation would be the same without the Contract (*Newsweek*, September 20, 1976).

Friedman paid a one-week visit to the United Kingdom in September 1974, centered on an Institute of Economic Affairs conference on inflation. The *Birmingham Post* provided a short item previewing Friedman’s visit and giving a capsule description of his views on inflation. The piece was uncontroversial except for the title: the article was headed “High Priest of Inflation,” though the text of the article clearly meant to convey something closer to “High Priest of Inflation Theory.” Friedman employed a clippings service to keep track of U.K. press coverage of himself, and so saw the item. The copy of this article that is kept by the *Birmingham Post* office is shown in Figure 8. It contrasts with the copy of the article that is stored at the Hoover Archives, which has multiple exclamation marks that Friedman marked in red ink next to the headline to express his incredulity. As Friedman had occasion to say in a later, similar moment of exasperation, “Why in God’s name isn’t it possible for the news media, for journalists in radio and television and the newspapers, to use the English language correctly?” (*San Jose Mercury News*, February 13, 1979.)



Figure 8. *Birmingham Post* item, August 21, 1974. (Courtesy *Birmingham Post* library.)

In a TV debate during his visit, Friedman faced Robert Neild who, as well as being the author of Keynesian academic work and a prominent contributor to the Radcliffe Committee’s (1960b) memoranda, had been a senior Treasury adviser in the 1960s. Although Friedman made good points in the interview criticizing U.K. Keynesian theory, Neild nailed Friedman on a factual issue. Listing the reasons that monetary authorities inflated, Friedman cited inflation as a source of revenue. It is uncontroversial that, *ex post*, inflation is a source of government revenue, but Friedman’s exposition gave the

impression that U.K. and U.S. policymakers *ex ante* had planned demand expansion at rates calculated to deliver inflation and the accompanying revenue. Neild appropriately questioned the relevance of this, noting that his own experience in government deliberations gave no support for a conscious creation of inflation for tax-raising purposes. Neild's point was very well taken, and Friedman was crediting U.K. policymakers with far too much knowledge of how to manage the inflation rate. Government revenue from inflation had been the subject of some of Friedman's more formal scholarly work in recent years (Friedman, 1971a), and he was perhaps too ready to view inflation rates in practice as applications of his analysis.

The TV debate and the Institute of Economic Affairs proceedings pushed Friedman back into realization of how far U.K. policymakers and many academics still were from accepting a monetary view of inflation. Reflecting on his visit a few months later, Friedman was particularly struck by the continuing popularity of the wage-push explanation. "In Britain, the explanation that everybody gives for inflation is that inflation is caused by trade unions, the greedy grasping laborers who force up the wages that cause inflation." (Friedman, 1975d, pp. 5, 7.) During his visit Friedman had written to *The Economist* saying he had "been dismayed, even in my few days in London, at the widespread support of 'union bashing' as a way to attack inflation." (*The Economist*, September 28, 1974a).

When he first published an article in a learned journal in 1935, Friedman could not have known that forty years later he would be writing a public endorsement of a book entitled *Ninety-Five Percent Is Crap*. Friedman was inspired to do this after being sent galleys of the book by the author, Terry Arthur. Arthur's book catalogued public statements on the economy by U.K. political and opinion leaders, bringing out logical inconsistencies, and subjecting their economic analysis to a critique from free-market and monetarist perspectives. Friedman, who was at the time writing about "Fed doubletalk" (*Wall Street Journal*, August 21, 1975), was impressed. "*Ninety-Five Percent is Crap* is a splendid book—amusing, disturbing, and profound," Friedman's endorsement began. "It exposes effectively the hollow doubletalk that has been undermining freedom. In the process, it presents effectively the case for the free market... [It is] just as relevant to the United States as to Britain." Friedman's endorsement arrived too late to be included in the

published version of the book (Arthur, 1975), but was quoted in U.S. press coverage.¹⁶³

While Friedman argued in 1978 that there was “almost no one who any longer has a good word to say about nationalization,” he had to admit that in the United Kingdom the trend had been to extension of nationalization (*The Listener*, April 27, 1978). Indeed, Harold Wilson’s account of his 1974–76 term in office (Wilson, 1979, p. 35) includes a six-line list of the nationalization plans his Government outlined in 1974, and the Labour Government did proceed to extend nationalization to the shipbuilding industry. With Thomas Balogh, one of Friedman’s Keynesian opponents, as one of the ministers responsible, the Department of Energy also increased the Government’s stake in the oil industry—leading to Friedman’s observation, “You have been nationalizing North Sea oil.” (*The Listener*, April 27, 1978.) Some of the oil-industry nationalization was wound back in the austerity measures of late 1976, when the Callaghan Government announced the sale of some of its interest in British Petroleum.

The U.K. private corporate sector over this period was suffering a pronounced squeeze. “Great Britain had a much more severe financial crisis than we did,” Friedman observed.¹⁶⁴ The stockmarket experienced a major collapse, its index standing in 1974 at its late 1950s value (Bordo and Wheelock, 2004), and the U.K. long-term corporate bond market virtually disappeared in the second half of the 1970s. Friedman noted that a “proper climate” for growth required “investment, enterprise, the ability to borrow capital” (*Dallas Morning News*, October 17, 1975), but in the U.K. case he observed that “the domestic capital markets are so disorganized by erratic inflation, excessive taxation, and government intervention...” (*Newsweek*, December 27, 1976).

It was, however, foreign exchange market turmoil that led to the United Kingdom negotiating a loan from the IMF in late 1976. The Callaghan Government appealed to the stringent terms of the loan as the reason it had to undertake cuts in government expenditure. Friedman maintained that the Government’s recourse to the IMF was just a charade: “Your government has gone to the IMF so that they can lay down rules for the management of your economy... It’s like the way big corporations use management consultants. The corporations know perfectly well what must be done, but they want to

¹⁶³ Most of the text of Friedman’s endorsement appeared in a contemporaneous U.S. news report on Arthur’s book (*Kingsport Times-News*, November 9, 1975). The remaining text was supplied by Terry Arthur to the author.

¹⁶⁴ *Milton Friedman Speaks*, Episode 5, p. 23 of transcript.

blame the unpleasant remedies on someone else.” (*Daily Mail*, September 30, 1976.) No doubt there was a considerable element of validity to this conjecture, as senior members of the Callaghan Government had indeed accepted the need to shift the division of resources between the public and private sectors, and needed a way to convince the Labour Party to accept the associated public sector cutbacks. But Friedman went too far with his further claim, “The British government knows that the only way to stop inflation is for government to spend less and to create less money.” (*Newsweek*, October 11, 1976.) This claim attributed, yet again, acceptance of a monetary view of inflation to the Government. Such an acceptance is not supported by the record of U.K. policymakers’ views or behavior; on the contrary, the Government continued to point to the Social Contract as a central part of its fight against inflation, and to claim that monetary policy alone could not defeat inflation. A wage-push conception of U.K. inflation continued to dominate, and the Government saw monetary targets (which it adopted in early 1976) as a means of helping avoid adding demand-pull to the wage-push pressures. Friedman subsequently pulled back from his late 1976 claim that the authorities knew inflation was a monetary phenomenon. In a November 7, 1977 talk, Friedman said, “If you listen to anybody telling you about Great Britain’s plight, they will tell you that the real problem in Great Britain is that you have such strong trade unions, that they push up wages and that causes inflation.”¹⁶⁵

When the Government announced its budgetary program in the wake of the IMF loan negotiation, Friedman pronounced himself unimpressed, pointing to the modest nature of the public expenditure cuts, the use of devices such as asset sales, and the failure to cut tax rates (*Daily Mail*, December 17, 1976). But, in part because of administrative changes that put spending limits in nominal rather than volume terms, the U.K. government expenditure share fell more after 1976 than had been expected (Cobham, 2002, p. 13). Friedman acknowledged this and said in February 1978 that a “rather curious reason for hope” was the fact that a “Labour Government for two years in a row has been led by political pressures to reduce government spending as a fraction of income.”¹⁶⁶

Another source of hope for Friedman was a speech that Prime Minister Callaghan made on September 28, 1976. The speech, written with the assistance of Peter Jay (who, as

¹⁶⁵ *Milton Friedman Speaks*, Episode 6, p. 6 of transcript.

¹⁶⁶ *Milton Friedman Speaks*, Episode 7, pp. 20–21 of transcript.

well as being an advocate of money supply control, was Callaghan's son-in-law), was widely interpreted as signaling a repudiation of fine-tuning and Keynesian demand management, and invoked elements of the natural rate hypothesis. Much of the initial reporting of the speech did not focus on the passages most recognizable as influenced by the monetarist viewpoint. But then coverage of the speech snowballed, with many U.S. newspaper articles quoting it (e.g. *The Detroit News*, October 23, 1976), and Arthur Burns began to refer to it (e.g., in Burns, 1977). Friedman quoted the speech in his *Newsweek* column (December 6, 1976) and in his Nobel lecture given in December 1976 (Friedman, 1977a). Truth to tell, Friedman cited the speech excessively,¹⁶⁷ and exaggerated its significance. The speech was not so dramatic a break with the past. The fact is that there were many occasions since the 1950s when Prime Ministers had talked about inflation moving up together with unemployment, and on the danger of overstimulating the economy. Callaghan's speech sidestepped the greater problem with U.K. policymakers' outlook on inflation, namely their appeal to nonmonetary explanations.

Around this time, Friedman reached a new level of fame in the United Kingdom. In 1975, Chancellor of the Exchequer had used both the terms "Friedmanite" and "Friedmanian"¹⁶⁸—neither in a complimentary fashion—and in 1976 the new edition of the *Oxford English Dictionary* added an entry for "Friedmanite." A further breakthrough was on November 30, 1976, when editorials about Friedman appeared in three London newspapers: a "quality" broadsheet paper (*The Guardian*), a tabloid (the *Daily Mirror*), and a broadsheet paper soon to turn tabloid (the *Daily Express*). The *Express* accompanied its editorial with a long interview of Friedman conducted by its U.S. correspondent Paul Dacre. Dacre's father, Peter Dacre, had made history in 1956 by being the first U.K. journalist to interview Elvis Presley; twenty years later, through his son's article, it was Friedman receiving the star treatment. Dacre's article was written as though it was introducing Friedman to U.K. readers, notwithstanding the fact that Friedman had given numerous in-depth interviews to the British media since 1970. Dacre's profile took Friedman to task for wearing vintage "1950 ties and frayed trousers," but added, "Whether you love or loathe him, his words have relevance for everyone in Britain." The article closed with a statement by Friedman that he hoped that

¹⁶⁷ For example, in *Free to Choose* (both the television and book versions), in *Milton Friedman Speaks*, in Friedman (1992, 1997), etc.

¹⁶⁸ Healey used "Friedmanite" in the *Washington Post*, June 22, 1975, and "Friedmanian" in *House of Commons Debates*, April 21, 1975, p. 1109.

“just as Britain has led the world down the path of socialism, she will lead us back out.”
(*Daily Express*, November 30, 1976a.)

U.K. press coverage also drew attention to Friedman’s visit to Chile in 1975. In the years following that visit, Friedman found that he had to discuss the issue over and over again, and he used the same main arguments each time:¹⁶⁹ that his visit to Chile was not unique—he had been to several dictatorships, including the USSR; that he felt that academic contacts with countries which had oppressive governments could help the process of political liberalization in those countries; and that the opinion he had offered on how countries could resolve economic difficulty had been the same irrespective of these countries’ political regime. Friedman insisted that the advocates of monetary control and free market reforms in Chile should not be tarred with the same brush as Chile’s junta: “There are old students of mine down there and I’ll be God-----d if I’m going to turn my back on them.” (*Sunday Times*, December 12, 1976.)

It is likely that these arguments made more headway with economists, for many of whom contacts with undemocratic countries about economic matters were not unusual, than they did with non-economist academics and with journalists. In the United Kingdom, *The Guardian* editorial and staff writers wrote harshly of Friedman. The *Guardian* editorial of November 30, 1976, labeled Friedman a “cantankerous old bigot” (though the “bigotry” cited was against existing levels of government spending), who was like a “jack-in-the-box... with an idiot grin on its face.” Its columnist Peter Jenkins described Friedman as the “the Chicago Charlatan... [who] engages in prescriptive clowning[.]... journalism and tele-punditry...” (*The Guardian*, December 9, 1976.) Protests became a routine part of Friedman’ public appearances. Anna Schwartz wrote in a 1979 profile of Friedman that “organized demonstrations have been conducted against him, not for views he holds, but for his supposed support of the military regime in Chile. A caricature of Friedman as a hardhearted reactionary has been invented.” (Schwartz, 1979, p. 67.)

Friedman appeared on BBC television in late 1976, in a studio debate taped in Chicago with former Wilson Government advisor and minister Thomas Balogh. In the debate, Balogh said, “I think that the Professor really is terribly naïve.” Friedman responded, “Well, I may be naïve but let me point out first that Mr. Balogh is simply defending his

¹⁶⁹ A compendium of his responses appears in the appendix to Friedman and Friedman (1998). See also Laidler (2007).

own record. Britain is in the position that it is because it listened to his advice and the advice of people who believe the way he does..." Friedman emphasized that he was not referring only to the Labour governments with which Balogh had been affiliated, but to postwar governments of both parties, which had "generally followed very much the same policies... I am trying to argue against the general drift that has affected both parties." (BBC1, December 6, 1976.)¹⁷⁰

"That great prophet of monetarism, Milt [sic] Friedman, is coming to Strathclyde University [in Glasgow, Scotland] in April to lecture on inflation," observed *The Scotsman's* business columnist at the start of 1978 (January 25, 1978). In April 1978, Friedman, now 65 and sometimes describing himself as retired, duly appeared in the home city of Adam Smith to give a lecture and press conference. At his Glasgow appearances, Friedman qualified his praise for the Callaghan government's reduction in the ratio of government spending to GDP with criticism of its extensions of government intervention in the marketplace. He also pronounced himself unimpressed by the practical changes made in U.K. monetary policy. "In Britain, monetary targets have been adopted but have not been kept. Mr. Callaghan has said there will be no fine-tuning, but Mr. Healey has been fine-tuning." (*The Scotsman*, April 22, 1978.)

Another aspect of the U.K. policy framework that was anathema to Friedman was the continued proffering of incomes policies—or in Friedman's (1976b, p. 233) blunt characterization, "general price or wage controls, euphemistically referred to as 'incomes policies'"—as a part of the Government's anti-inflation strategy. Friedman had observed early in the U.S. wage/price control experiment (*Newsweek*, January 31, 1972): "Experience in other countries [beside the United States] suggests that for about a year such controls generally look good; after about two years, they collapse." The incomes policies put in place in the United Kingdom from 1972 to 1979 fell roughly into the pattern Friedman described. Heath's wage-price controls imposed in 1972 suppressed inflationary pressure for about a year before a breakout at the end of 1973 and in early 1974. The Social Contract of the Wilson Government was largely violated until a more

¹⁷⁰ Friedman recalled later (Friedman and Friedman, 1998, p. 247) that he deliberately used "Mr. Balogh" instead of "Lord Balogh" to the irritated response of Balogh. Similarly, Friedman needled Nicholas Kaldor by referring to him as "the good lord" (*The Times*, May 2, 1977). In defense of Balogh and Kaldor, neither of them threw their titles around to the same degree as Richard Kahn, their fellow member of the House of Lords. For example, in letters to *The Times* (October 22, 1980a and b), Balogh and Kaldor each signed themselves using their "commoner" names "Thomas Balogh" and "Nicholas Kaldor." Kahn, by contrast, followed Keynes' example and signed himself in the surname-only, all-upper-case form. So Kahn signed his letters to *The Times*, "I am, Sir, your obedient servant, KAHN." (E.g., *The Times*, October 5, 1974.)

legally binding version was introduced in July 1975. U.K. inflation then generally declined for three years (1975–78), not two. But monetary policy had been tightened in late 1975 and over 1976; it was only from early 1977 that the Government’s incomes policies were attempting to push inflation away from the direction implied by monetary policy. The substantial monetary stimulus created in 1977 was followed by a collapse of the Social Contract at the end of 1978 and at the beginning of 1979. Shortly afterwards, the Callaghan Government lost a confidence vote in Parliament and had to hold a general election.

Friedman’s travels, interviews, and commentary on current events meant that the Friedman-Schwartz *Monetary Trends* study of the United States and the United Kingdom was being slowed down. Friedman told an audience in Sheffield, England, in September 1970, “Mrs. Anna Schwartz and I are currently engaged on a comparison of U.S. and U.K. monetary trends... I had initially hoped to present a paper on this work at this seminar, but unfortunately the research did not go rapidly enough.” (Friedman, 1971b, p. 151.) In both that presentation and in Friedman lectures in the following years (Friedman, 1972c, 1973a), the U.K. coverage was limited mainly to discussions of data plots. Friedman and Schwartz (1972, p. 32) admitted, “Our estimate of the time it would take us to complete the manuscript on monetary trends has been unduly optimistic in the past... [W]e shall refrain from projecting a date for completion.” The publication of Schwartz (1975) indicated that progress was being made, and by 1979 the project was edging to the finishing line, with publication projected for sometime in the early 1980s.

ISSUES, 1970–1979

COMMON MARKET ENTRY

Though he sometimes referred to the “European countries and Britain” (e.g., in Pringle, 2002, p. 22), Friedman usually counted the United Kingdom as part of Europe. In 1948 Friedman referred to “Europe, including England” (*New York Times*, January 11, 1948), and classed the United Kingdom within Europe or Western Europe on later occasions too, including in Friedman (1958a, p. 510) and Friedman and Schwartz (1982, p. 309). A major issue for the United Kingdom in the 1960s and continuing into the 1970s was whether it should join other major European countries in the European Economic Community or Common Market. Friedman reminded people that he played a part in the preparations for “the so-called Coal and Steel Community—a precursor to the Common

Market” when he served as an advisor to the Marshall Plan in 1950 (*Newsweek*, May 24, 1971). In 1967, Friedman warned London newspaper readers not to expect too much of EEC membership. “Membership of the Common Market may or may not be good for Britain, but it is not a necessary part of the solution to Britain’s difficulties. Germany in 1948 achieved an economic-miracle policy by decontrol without any Common Market.” (*Sunday Telegraph*, June 25, 1967.)

After unsuccessful attempts to negotiate entry in the 1960s, the United Kingdom joined the EEC at the start of 1973. By then, Friedman had expressed concern about the direction of the EEC, in particular the danger that it was “dominated by the notion that it’s to serve as the super-central planning body” for member countries (*Vision*, April 1972). One of the planning measures undertaken by the EEC also went against Friedman’s belief in free trade. “So far as the Common Market is concerned, they have engaged in agricultural protectionism on a large scale, as you say,” Friedman observed in April 1978.¹⁷¹ “They are making a mistake in doing that.” In late 1978, the EEC started to move against something Friedman regarded as one of the few favorable economic policy developments in the 1970s: floating exchange rates. The European Monetary System (EMS) was set up at the end of 1978, to commence in 1979. But, for now, the United Kingdom would not be participating. The Callaghan Government had decided to stick to a floating pound.

TAX EXILES

During his 1970 visit to the United Kingdom, Friedman remarked, “you have an extraordinarily high set of tax rates.” (*Sunday Times*, September 20, 1970.) Even when the United States had a top federal income tax rate of 70%, as it did throughout the 1970s, the United Kingdom was known internationally for its high income tax rates. The high income tax burden started at the bottom of the scale: a 1977 examination found that the tax-free income threshold was lower only in Sweden and Ireland among the major economies, and that the United Kingdom had the highest initial tax rate of 35% (*New Society*, March 17, 1977). The maximum income tax rates in the United Kingdom were notoriously high too: over 90% until 1971, cut to 75% in 1971, then raised to 83% in 1974 (*The Economist*, April 7, 1979). For what was called “unearned” income (i.e., investment income), the rate prevailing during the second half of the 1970s was 98%.

¹⁷¹ *Milton Friedman Speaks*, Episode 8, p. 26 of transcript.

In a 1971 radio interview, Friedman said, “I find it hard to believe that Britain, too, would not be able to get by with a vastly lower rate of tax.” (*The Listener*, February 11, 1971.) In a BBC television interview in December 1976, Friedman named tax reform as essential for repairing the U.K. economy. The reform he recommended would “eliminate the present punitive tax of 98% at the top on unearned income, 80%-odd on earned income, and restructure the tax system so that instead of becoming a mechanism for punishing people... it becomes a mechanism, for enabling the government, on the one hand, to raise revenues and leaves an incentive for ordinary people, on the other hand, to devote their energies and efforts to work and to save.” (BBC1, December 6, 1976.). A step in this direction, bringing the U.K. income tax rate down from 83% to the 70% U.S. top rate, would according to U.K. government estimates reduce tax revenue by only 85 million pounds (*New Society*, March 17, 1977). Anthony Lewis, a *New York Times* columnist who did not usually see eye-to-eye with Friedman, said that the unwillingness of the U.K. Government to cut the top rate to 70% reflected “the formulas of yesteryear,” and specifically an appeal to “the politics of envy” (*New York Times*, August 5, 1976).

A Minister in Labour governments during the 1970s, Edmund Dell, claimed that these tax rates were not really binding on U.K. taxpayers.¹⁷² It is true that there were various well-known channels which those facing high marginal tax rates could use. In particular, those employed in corporations could attempt to have their income paid in forms other than labor income. One practice was to conceal salary increases in the form of reimbursements to executives for business expenses (*Financial Times*, March 17, 1954). Another practice was the provision of extensive fringe benefits. The *Financial Times* estimated in 1966 that fringe benefits typically totaled over 30% of executive income in the United Kingdom (*Financial Times*, October 19, 1966). For example, the company might provide executives with cars or even suits. Because corporation tax was less severe, there were also strong incentives for taxpayers to incorporate themselves. A further option for top-income residents was to work offshore for part of the year. Friedman remarked, “Tax fiddling is by no means a minor occupation in Britain... It is a shame that there should be laws which force men to break them and get around them.” (*The Listener*, April 27, 1978.)

Despite Dell’s claim to the contrary, the channels available for minimizing reported labor

¹⁷² Dell (2000, p. 69) states, “High tax rates have been levied but always in ways that allowed escape routes to those well advised.”

income do not appear to have been sufficient for high-income earners to escape paying the top-bracket rates. The 1966 *Financial Times* analysis said that, despite fringe benefit payments, “it is impossible not to conclude that U.K. direct taxation acts as a strong disincentive at top management levels.” The situation deteriorated in the 1970s, despite minor reductions in the nominal top rate, and by 1977 even Alec Cairncross was pointing to the 83% top-bracket rate, and admitting, “The average manager feels he doesn’t have any incentive to exert himself.” (*Courier-Journal and Times*, April 3, 1977.)

For some high-income earners, such as those in the entertainment industry, the scope for reporting income other than as labor income was limited. The response to this situation was the “fame drain” or “tax exile” phenomenon of the 1960s and 1970s, as many British entertainers left to lower-tax countries. “Innumerable film stars and pop stars have gone,” a 1976 report explained, “[including] Rex Harrison, Dirk Bogarde, Sean Connery, Richard Burton, Mick Jagger, Tom Jones.” (*Omaha World-Herald*, April 20, 1976.) Indeed, a recurrent feature of showbusiness interviews over this period is the complaining from entertainers about U.K. taxes. Richard Burton explained in an interview why he and his wife Elizabeth Taylor had moved to Switzerland: “Some years, our joint income is vast—something like two or three million dollars. We don’t much care for paying out 60 percent of our money in tax. We don’t mind a bit giving it away for causes we support or to people we know. But give it to Heath or Wilson? Not bloody likely!” (*Evening Post*, September 26, 1970.) Robert Shaw explained his move to Ireland: “You could not find a more patriotic Englishman than me, but why should I pay 94 per cent of my earnings to the Government?” (*Daily Express*, November 17, 1977.) Roger Moore accounted for his departure from the United Kingdom for Switzerland: “I was paying 83 per cent in taxes, while being in a position where, if I managed to save anything from the remaining 17 per cent, and invested it, I was taxed 98 per cent on the profits.” (*Sunday Sun*, November 26, 1978.) Jane Seymour stated, “In England, I was paying 85 percent in taxes.” (*Omaha World-Herald*, February 9, 1977.)

An aspect of Robert Shaw’s complaint about U.K. taxes actually illustrated a point that Friedman made on a number of occasions. Shaw said, “I think it’s unfair. I don’t come from a rich family. I am a self-made boy, my father was an alcoholic who died when I was 11, my mother had £5 a month to live on, and we used to walk seven miles to school. I never earned any real money until I was 38. In my best year until then I made £2,000. Money is the only real incentive, except to fanatics. The taxation system is so stupid.” (*Daily Express*, November 17, 1977.) A point Friedman had made in *Capitalism and*

Freedom was that the existing steeply graduated income tax system (Friedman rejected the “progressive” label for the system),¹⁷³ by hitting incremental increases in wealth, froze in place the preexisting wealth distribution and so protected those already wealthy (Friedman, 1962a, p. 173). Friedman observed in a 1974 BBC radio appearance that “in the United States and the United Kingdom... graduated income taxes are not a tax on *being* wealthy but a tax on *becoming* wealthy... The problem with high, graduated income taxes is that they make it extremely difficult for people who start out from the bottom to accumulate enough to break into the upper classes. In that way, they are essentially a protection of special privilege.”¹⁷⁴

In his 1978 speech in Scotland, Friedman had observed, “The public at large is restive. A tax revolt is brewing everywhere.” (*The Listener*, April 27, 1978.) By mid-1979, Harold Wilson, who had presided over the 83% (or higher) top marginal tax rates, recognized that there was a problem. A committee that Wilson chaired reported, “The financial penalties of the present system of United Kingdom tax—both in terms of high marginal rates of income tax and of the period for which they can work in the United Kingdom without attracting these rates—are such that those whose presence is so vital go abroad and often cannot be persuaded to work in the U.K. even on an individual film.”¹⁷⁵

Friedman saw the tax-exile problem as having repercussions also for the Keynesian-monetarist debate in the United Kingdom. U.K. academic salaries were typically not at a level that would make the 83% top-bracket rate applicable; but, as noted above, even initial tax rates were penal in the United Kingdom compared to other countries. Thus there was a strong incentive for those economists who had become internationally established to move to more attractive positions in other countries. Monetarists disproportionately figured among the economists who established their reputations in the late 1960s and early 1970s, so their departure shifted the balance toward the Keynesian establishment. In consequence, Friedman noted in 1976 that U.K. “economists who[m] I know have been leaving” (BBC1, December 6, 1976), forming part of the “brain drain of many of the ablest young men to countries where taxes are lighter” (*Newsweek*, November 8, 1976). In particular, David Laidler and Michael Parkin emigrated to Canada in 1975; Alan Walters left for the USA in 1976; and David Sheppard moved to

¹⁷³ “What we call erroneously our progressive income tax system...” *Milton Friedman Speaks*, Episode 14 (51 minutes into Idea Channel DVD of episode).

¹⁷⁴ In Vaizey (1975, p. 71).

¹⁷⁵ Wilson Committee (1979, p. 11, para. 52).

the Caribbean in 1976, later shifting to New Zealand. The practical effect, as Friedman saw it, was to turn the erode much of the progress that had been made in U.K. academia away from a concentration on extreme Keynesian views. The hardline Keynesian tendencies, Friedman (1978a) said, had “been increased by the disproportionately high rate of emigration to the U.S., Canada and elsewhere of the ablest economists, who are also disproportionately monetarist in their scientific persuasion.” Confirming this pattern, Karl Brunner noted that “Keynesian analysis still thrives, even in archaic forms” in the United Kingdom (*The Banker*, July 1978.)

COLD WAR

Friedman had a very strong interest in the subject of foreign policy.¹⁷⁶ But he recognized that it was a “subject... rather far removed from economics” (Friedman, 1981, p. xiv) and, on a panel with Paul Samuelson in 1950, Friedman said, “Let us leave out the Cold War.”¹⁷⁷ After he became more of a public figure, however, Friedman started breaking his rule of refraining from comment on foreign policy. During Congressional testimony with Samuelson in 1971, Friedman included a rambling discussion of U.S. foreign policy since World War I, and was upbraided by Samuelson, who said: “I am not going to comment upon the view of history we have just had, but confine myself to economics.”¹⁷⁸

A further departure by Friedman from his economics brief into punditry on foreign policy occurred during 1976. In a *Newsweek* column (May 24, 1976), Friedman, who disliked the use of economic sanctions, speculated on the possibility that Western sanctions against South Africa might leave that country open to be Soviet client state. It was a column with very little economic content. Though it is not clear that there was a firm connection, his choice of subject matter may have played a role in the decision during 1976 by the editors of the international version of *Newsweek* to cut down on the publication of Friedman’s columns. Whereas before 1976 Friedman’s U.S. *Newsweek* columns appeared regularly in *Newsweek International*, after 1976 only about two of every three Friedman columns saw print in the international version. Since the United Kingdom carried the international version of *Newsweek*, the change meant reduced reach of Friedman’s columns to U.K. readers.

¹⁷⁶ Remarks by Anna Schwartz to author *en route* to Vermont Great Inflation conference, September 25, 2008.

¹⁷⁷ All Participants (1951 p. 241).

¹⁷⁸ Samuelson in September 23, 1971 testimony to Joint Economic Committee (1971, p. 723).

Friedman's straying into a discussion of Cold War geopolitics was unusual, not only because of the lack of genuine economic content but because, when he had previously discussed the Soviet Union, he usually offered observations that set him apart from traditional "hawkish" commentators. While Friedman made clear that "of course I'm aware that the Soviet Union is a major potential foe,"¹⁷⁹ and in *Capitalism and Freedom* he had talked about the "the evil men in the Kremlin" (Friedman, 1962a, p. 201), he had departed from Cold Warriors by urging normal trade relations (other than in strategic goods) with the Eastern bloc, and in opposing conscription both as a wartime and peacetime measure in the United States. He had never signed up to the fears, prevalent in the late 1950s and early 1960s and well described by Krugman (1994), about Soviet economic strength. Rather, Friedman (1958b, p. 35) was skeptical about the Soviet leaders' "claims of great economic accomplishments," and pointed to the stagnation in the standard of living to increase in the USSR (Friedman, 1957b, 1958a).

In his remarks during the Nobel celebrations in Sweden in December 1976, Friedman voiced concern about straying outside economics, observing that "we badly need an antidote" for "the inflated attention granted a Nobel laureate in areas outside his competence."¹⁸⁰ Nevertheless, in late 1977, Friedman devoted a second column to speculation about South Africa and the USSR teaming up (*Newsweek*, November 28, 1977). This column was not printed in the international edition of *Newsweek*.

It was only later that Friedman seems to have taken to heart the concerns he had voiced about straying from economic subjects. "I don't like to talk about foreign policy, because it is not my field," Friedman said in January 1982 (*The Capital*, January 21, 1982).¹⁸¹ In 1984, he added, "I've tried very hard over the years to avoid shooting my mouth off on subjects on which I have no competence. It seems that destroys your credibility in an area where you really *have* something to say." (*California*, October 1984.) Friedman's comments on foreign policy and defense became peppered with appropriate qualifications. In 1983: "I am no defense expert." (*Newsweek*, April 18, 1983.) In 1984: "We are not ourselves defense experts."¹⁸² And in 1987: "Fortunately I am not a military expert." (*Jerusalem Post*, November 10, 1987.)

¹⁷⁹ Remarks at December 1979 Stanford University conference, in Anderson (1982, p. 199).

¹⁸⁰ December 1976 remarks, quoted in Friedman and Friedman (1998, p. 454).

¹⁸¹ While criticizing the 1976–77 Friedman columns referred to above, Rayack (1987, p. 176) acknowledges that, in aggregate, Friedman had written "little... on defense and foreign policy."

¹⁸² Friedman and Friedman (1984, p. 70 of U.S. edition).

DEMOCRACY

Like Keynes before him, Friedman in his work talked about the damaging effects that inflation could have on the stability of a democracy. For example, Friedman opened his testimony to Congress in May 1959 with: “Unless we can achieve both a reasonably stable economy in the short run and a reasonably stable price level in the long run, our free enterprise economy is unlikely to be permitted to survive.”¹⁸³ In further testimony later that year, Friedman said, “Wars aside, the chief economic threats to the preservation of a free society have come from the sharp fluctuations... in economic activity and in prices... that have threatened to tear the social fabric asunder.”¹⁸⁴ Another theme in his work, central to Friedman (1962a), was the presence of a sizable private sector as a necessary condition for political freedom.

Friedman produced a storm when, in 1976, he made use of these two themes to discuss the state of the United Kingdom. On *Meet the Press* (October 24, 1976), Friedman said, “Great Britain is another horrible example... Britain is on the verge of collapse.” Around the same time, *Encounter* magazine published an article by Friedman, arguing that the public sector had become so large a fraction of the U.K. economy that democracy was threatened: “I fear very much that the odds are at least 50-50 that within the next five years British freedom and democracy, as we have seen it, will be destroyed.”¹⁸⁵ The controversy intensified when Friedman made similar remarks in a *60 Minutes* special on the U.K. economy broadcast in the United States on November 28.

Friedman’s observations produced a backlash in the U.K. press. The *Daily Mirror* called Friedman the “smiling man of woe,” and an editorial criticized his “biased view” and “doomsday solutions” (November 30, 1976c and 1976d). The *Daily Express* (November 30, 1976e) said that Friedman’s “sensible followers in this country—particularly Mrs. Thatcher and Sir Keith Joseph—must be in near despair” about his “absurdities.” Actor Robert Morley satirized Friedman’s prognosis by offering as a mock prediction for 1977, “a distinguished American economist will give Britain six months to live.” (*Liverpool Daily Post*, December 31, 1976.) John Kenneth Galbraith joined in the criticism, observing, “If the economists were right every time they predicted a country was going down the drain, there would be nowhere left.” (*Daily Mirror*, January 10, 1977.)

¹⁸³ Friedman, May 25, 1959, testimony in Joint Economic Committee (1959a, p. 605; p. 136 of reprint).

¹⁸⁴ October 30, 1959, testimony, in Joint Economic Committee (1959b, p. 3020).

¹⁸⁵ Friedman (1976c, p. 9); also published in *Sunday Telegraph*, October 31, 1976.

The criticism that prompted Friedman to react came from Samuel Brittan. Brittan published an open letter to Friedman in his *Financial Times* column, arguing that “your recent warnings about the United Kingdom... represent personal hunches, individual value judgments or exaggerations” which could detract from Friedman’s insights on monetary matters (*Financial Times*, December 2, 1976). Friedman in turn had an “Open Reply” to Brittan defending his statements (*Financial Times*, January 6, 1977), and in a February 1977 speech, he maintained, “It will be touch and go whether over the next five years Great Britain will be able to maintain a free society...”¹⁸⁶

This backlash against Friedman’s warnings reflected a certain inconsistency on the part of U.K. commentators. A substantial number of U.K. leaders and U.K. economists had made comments similar to Friedman’s about the threat to democracy coming from economic instability. For example, in a September 1976 television interview, Prime Minister Callaghan had said, “If we were to fail, I don’t think another government could succeed. I do not think that would mean a National [coalition] government. I fear it would lead to a totalitarian government of the Left or the Right.” (*The Sun*, October 1, 1976.) An economist at the Bank of England, Charles Goodhart, had warned (1975, p. 221) that continued stagflation of the sort the Western economies had faced in the 1970s “may well serve to destroy the atomistic, democratic, capitalist structure of their existing system.”

One element that contributed to the controversy was Friedman’s emphasis on the threat to democracy from a large government sector rather than from inflation alone. Friedman was not, however, conflating the issues; he explicitly maintained that excessive growth of government did social harm even if it were not accompanied by inflation. “Ending inflation, in my opinion,” Friedman said in 1981, “is a very desirable thing to do. In my opinion, it is likely to be a necessary precondition for resolving the other problems that countries have, but it is not a be-all and end-all of economic policy.” (*Evening Post*, April 27, 1981.) In particular, Friedman contended that an inexorable rise in the government spending share of GDP, “even if were accomplished without any inflation whatever, ... would ultimately destroy our freedom and society” (*Evening Capital*, November 18, 1978).¹⁸⁷

¹⁸⁶ In Friedman (1978c, p. 8).

¹⁸⁷ A prior occasion on which Friedman separated the issues of inflation and the “threat to the maintenance of a free society” from a large public sector was in a letter to *The Economist* (September 28, 1974a).

It was Friedman's discussion of the U.K. government-to-GDP share that became where a number of commentators took him to task. The figure he used in Friedman (1976c) and elsewhere of 60% was indeed the figure reported by U.K. government publications as of early 1976. But revisions during the year exposed double-counting, and the official estimate was revised to about 45%-47%. Chancellor Healey said that the corrected number refuted "the picture of a profligate public sector as ignorantly presented by Professor Milton Friedman" (*House of Commons Debates*, November 30, 1976, page 715). Some discussions, such as Begg (1987) and Tomlinson (1990), mention Friedman's use of the 60% figure and create the impression that, had the corrected number being known from the start, there would have been no basis for Friedman's warnings about public expenditure in the United Kingdom. This is questionable; for one thing, Friedman stressed that his argument did not rest on the present number being as high as 60% (BBC1, December 6, 1976). For another, Friedman would likely not have agreed with all the statistical decisions used to reach the 45%-47% share. Factual disputes over the size of the U.K. public sector did not begin in 1976, and often came down to differences in economic analysis rather than just questions of data accuracy. For example, a debate in the *Financial Times*—before the rise in government spending in the 1970s—led to estimates of the government spending/GDP share of 41%-45%, depending on the treatment of government enterprises (*FT*, May 1, 1967; *FT*, May 5, 1967). Friedman likely would have insisted that subsidies to firms and transfer payments to individuals be counted in the government spending aggregate, and not (as is often the practice) as "negative taxes." My suspicion is that an estimate that classed these items as spending and which was sure to include all government enterprises in the government-spending estimate, would show the share peaking above 50% during the mid-1970s.

PERSONALITIES, 1970–1979

NICHOLAS KALDOR

Friedman observed in his Harold Wincott Lecture in London that "[c]oming back to Britain... always mean coming back to a warm circle of friends or friendly enemies."¹⁸⁸ As the debate on monetarism took shape in the United Kingdom, it became clear that one of the most prominent "frienemies" was Nicholas Kaldor, whom Friedman had known since the 1930s. Kaldor allowed that "his [sic; *his and Anna Schwartz's*] monumental

¹⁸⁸ Friedman (1970a, p. 1).

book, *A Monetary History of the United States*, is an interesting piece of history and makes good reading” (*The Times*, April 6, 1977). But there Kaldor’s praise stopped.

Kaldor exemplified the extreme positions that distinguished postwar Keynesianism in the United Kingdom from postwar Keynesianism in the United States. Friedman had said in a 1969 television interview, “The fact is that while everybody today uses Keynesian language, nobody today in the profession any longer accepts [all] the ideas that Keynes expressed or that were current in, let’s say, 1945 or 1950.” (WNBC, May 4, 1969.)¹⁸⁹ Friedman’s visit to the United Kingdom in 1970 convinced him, however, that this statement did not carry over to the U.K. economic debate: he observed that the “shift, so far as I can detect, has been greater in the United States” (1970a, p. 13) and that the criticisms he was encountering in the United Kingdom” were “at the naïve, unsophisticated level we encountered in the USA about five or more years ago.” (1970a, p. 14).¹⁹⁰

The Radcliffe Report had given Friedman a heads-up about the skepticism regarding monetary policy prevailing in the United Kingdom. Kaldor had given testimony to the Committee and reviewed the Report enthusiastically (see Kaldor, 1960). But the appearance of Kaldor’s (1970) “The New Monetarism” shortly before Friedman’s visit showed that the Radcliffe viewpoint was still thriving and that Kaldor was still an enthusiastic exponent of it. In that lecture and in related work (see Kaldor, 1982), Kaldor repeated the familiar Radcliffe positions such as interest-inelastic aggregate demand and pure cost-push inflation behavior. Kaldor reaffirmed traditional Keynesian arguments by contending that fiscal policy had powerful effects: whereas Friedman and Meiselman had argued that the correlation between fiscal actions and economic activity reflected the fact that fiscal actions in certain periods were correlated with the money stock, Kaldor advocated the reverse position—that the correlation between money and economic

¹⁸⁹ The observation that all economists use Keynesian language but do not necessarily accept the initial Keynesian economic analysis, also appeared in Friedman (1968a, p. 15) and in his letter to *Time* of February 4, 1966. It was not a position original to him, being used explicitly by Burns (1947) and Schlesinger (1956). Ironically, the negative connotations that Keynesian terms like “income-expenditure theory” and “fine-tuning” acquired from the impact of Friedman’s work meant that Keynesians began to avoid their use, thus making the observation about a universal language less true.

¹⁹⁰ This was one of relatively few occasions that Friedman made explicit reference to the tendency for the U.K. academic and policymaking community to take more extreme views on monetary policy than their U.S. counterparts. Another such reference, noted above, was in Friedman (1978a); see also Friedman (1997) and his article in *The Economist*, June 4, 1983. In addition, in a letter to the present author dated November 12, 1991, Friedman wrote, “I have no reason to disagree with you at all about the gap between American monetary economics and monetary economics as perceived in Australia and Britain.”

activity reflected the fact that money had historically been correlated with the fiscal balance. Kaldor also restated the Keynesian position that U.S. monetary policy had been powerless in the 1930s. Kaldor was not articulating views that were outlandish by U.K. standards; on the contrary, *The Economist* (November 9, 1968) described Kaldor, who had served as an advisor to the Wilson Government during the 1960s, as having “fairly orthodox” views. Most of the more extreme statements about the incapacity of monetary policy that Kaldor made had analogues in statements during the 1960s and 1970s by many other U.K. economists.

It is on the issue of causation that Kaldor (1970, 1982) is given credit in some circles as a pioneer. Kaldor argued that in the modern, “credit money” financial system—by which he seems to have meant a system in which most money is deposit money, and where deposit creation is typically associated with loan creation—it was impossible for central banks to influence the money stock. If, he argued, the authorities undertook measures that delivered them control of the money stock, their actions on money would face permanent, completely offsetting movements in velocity. Historical relations between money and other variables, according to this argument, simply reflected reverse causation—the passive creation of money in response to price and output movements. Price and output behavior would, it was argued, not have been different, if the monetary authorities had somehow prevented this money creation from taking place.

This is not a line of argument that U.S. Keynesians generally used, and the reaction to Kaldor’s work has been split largely by geographical frontiers. In some parts of Europe, mainly the United Kingdom and Italy, Kaldor has been (or was) hailed as a genius in monetary economics. In the United States, on the other hand, outside the small Post-Keynesian field, the reaction has been to view Europe’s hailing of Kaldor as a monetary genius in much the same way that the United States views Europe’s treatment of Jerry Lewis as a filmmaking genius. The U.S. reaction to Kaldor’s monetary positions was very similar among monetarists and Keynesians. Friedman said in 1985 that he thought that Kaldor was “simply factually wrong”;¹⁹¹ fifteen years earlier, Paul Samuelson (1971, p. 14) had said, “Kaldor is simply wrong.”

Commercial bank and private sector actions do play a role in determining the growth of monetary aggregates; and central banks in practice have not used the monetary base or

¹⁹¹ From Friedman’s letter to J. Daniel Hammond of June 13, 1985, quoted in Hammond (1992, p. 116).

broader aggregates as their policy instrument. The two points that are ostensibly the key to Kaldor's causation argument, are therefore valid. Why then is Kaldor's argument so widely regarded, and I believe correctly regarded,¹⁹² as erroneous? The core monetarist literature (both that of Friedman-Schwartz and Brunner-Meltzer) had discussed the endogeneity issue many times. Kaldor's argument would be refuted if different choices for the volume of open market operations could be relied upon to produce different implied paths for the money stock. This *ceteris paribus* condition is widely regarded as satisfied,¹⁹³ which is why monetarist positions about central banks being able to affect monetary aggregates, aggregate demand, inflation, etc., in a systematic manner are widely accepted.

The way that Friedman (1970d) answered Kaldor was by appealing to the fact that money had been connected to income and inflation under many different monetary arrangements, undermining an explanation of the correlation like Kaldor's that relied on the existence of a particular policy regime or on the institutional conditions prevailing in the United Kingdom. Kaldor (1982, pp. 26–27) claimed that the money/income relation differed greatly across countries, but the evidence he presented on this point pertained to the different secular growth rates of velocity across economies. The monetarist literature, however, did not claim that the velocity trend was identical across countries; and it does not have to be the same across countries for the relationship between money growth and inflation to be close in each country.¹⁹⁴

As the monetarist movement picked up steam during the 1970s, Kaldor continued to be a leading U.K. critic. He particularly disputed the existence of a lag from money growth to inflation. Goaded into a second reply to Kaldor in 1977, Friedman pointed out that the lag from money growth to inflation was observed in both the United Kingdom and the United States.¹⁹⁵ Kaldor had argued that the only case of a lag from money growth to inflation was that observed between U.K. broad money growth and inflation in the mid-

¹⁹² On a personal note, I read Kaldor's work from an early point in studying economics and benefited from seeing an interpretation of matters diametric to that in the monetarist literature. I also worked for several years as advisor/assistant to Christopher Allsopp, who had been Kaldor's advisor/assistant during the 1974–76 Wilson Government, and who knew Kaldor, as Friedman did, as "Nicky."

¹⁹³ See Nelson (2003, pp. 1042–1044) for an elaboration.

¹⁹⁴ See Nelson (2003, p. 1037) and Parkin (1980) for further discussion

¹⁹⁵ *The Times*, May 2, 1977. This publication, a letter to the editor, was one of the last to give the University of Chicago as Friedman's location and main affiliation. Friedman had already moved to California and was officially retiring from the University of Chicago at roughly the time the letter was published.

1970s, and that this had been a spurious connection. This position of Kaldor's does not stand up well, partly because of the international evidence that Friedman cited, and partly because Kaldor's claims do not appear valid for the United Kingdom. In particular, Kaldor implied that a lag from money growth to inflation is not observed in the United Kingdom for data excluding the mid-1970s or for narrow measures of money. This claim does not appear to have been true empirically at the time, and has not been true of subsequent sample periods. Modern U.K. monetary policymaking is predicated on a substantial lag from monetary policy actions to inflation.

JOHN KENNETH GALBRAITH

“Well, John Kenneth Galbraith is one of the Canadian exports to the United States that we might have done without,” was Friedman's (1982a, p. 49) response when asked by an interviewer, “What do you think of John Kenneth Galbraith?” It was not a question which most academic economists had to concern themselves with much; as Baumol and Blinder (1979, p. 822), their general response to Galbraith was to ignore him. To the public at large, however, Galbraith and Friedman were often grouped as representatives of different schools of academic opinion, and thought to be of comparable stature in the academic community. This perception, or misconception, held particularly in the United Kingdom.

Well before Friedman was well known, Galbraith had acquired a reputation in the 1950s and 1960s in the highbrow U.K. press as a leading economist, and one of the premier Keynesians. He was also felt to have set the benchmark for clarity in writing on economic issues for a general audience; Samuel Brittan, for example, wrote in a book review for the *Financial Times* (October 24, 1960) that in communicating economic ideas, the reviewed author was “no Galbraith.”

It was this image that led to Galbraith receiving the opportunity in 1977 to host a BBC television series, *The Age of Uncertainty*, giving his take on economics. A newspaper interview in connection with the series gave Galbraith (whom the article described as “one of the world's top economists”) the opportunity to talk about Friedman. “Milton Friedman, and he is a personal friend, is a man who is not usually wrong—except on economics,” Galbraith remarked. (*Daily Mirror*, January 10, 1977.)

Friedman gave a talk about Galbraith's economics at the Institute of Economic Affairs in August 1976. Via his review of the scholarly literature critiquing Galbraith, Friedman took the opportunity to talk about research outside his own scholarly field and to pay tribute to the researchers involved (whom he pointed out in the audience). Friedman topped and tailed this showcase with his own observations about Galbraith's ideas. It was questionable whether talking about Galbraith's economics was the best use of Friedman's time. But the published version of the talk (reprinted in Friedman, 1978c, 1991) earned high praise from Lionel Robbins. The publication date dovetailed with the broadcast of *The Age of Uncertainty*. Robbins said that he had avoided watching the series but that he had been informed that it was appalling.¹⁹⁶

Galbraith played a negligible role in the Keynesian-monetarist debates in the academic world, but Friedman's willingness to present a critique of Galbraith surely increased the perception of Galbraith as one of Friedman's leading scholarly adversaries. In the 1980s Galbraith enjoyed a profile in the United Kingdom as a major figure in the debate on monetarism. A preliminary skirmish was in 1978, when Galbraith argued that Friedman's policies had been tried in Israel and had led to 30% inflation. This prompted a letter by Friedman to *The Times* (August 15, 1978), which stated that while "Ken gives me full credit—and blame" for Israel's economic policy, the only parts of Friedman's prescriptions actually implemented by the Israeli government were floating the exchange rate and loosening foreign exchange controls. Overall, said Friedman, there had been little movement of policy in the direction he had recommended, and this was the case not only "for Israel, but for the U.S. and the U.K. as well."

MARGARET THATCHER

"It's not my job to persuade people about things," Friedman argued (*Omaha World-Herald*, October 20, 1976). "I just develop ideas and leave them around for people to

¹⁹⁶ Letter to Friedman from Lionel Robbins, February 2, 1977, Friedman correspondence, Hoover Archives. Robbins went on to express incredulity that the BBC could have treated Galbraith's series as though it was an economics analogue of the prestigious television work of Kenneth Clark. Clark was an academic who hosted a television series *Civilization*, on the subject of the history of art (and, therefore, a series which Friedman would have judged well worth skipping). Clark's personalized documentary format was believed to be a template for Galbraith's series on economics. Clark's son Alan wrote a history of the Conservative Party called *The Tories* (Clark, 1997) which, despite extensive coverage of economic policy in the Heath and Thatcher periods, managed to avoid mentioning Friedman even once. Clark's book also referred, in both the index and text, to Lionel Robbins as "Professor Harold Robbins" (Clark, 1997, p. 285), an apparent confusion of Robbins' name with that of the author of *The Betsy* and other saucy 1970s novels.

pick up.” Among those seen as picking up Friedman’s ideas in the late 1970s was Margaret Thatcher, who had replaced Edward Heath as Conservative Party Leader in February 1975. Some have claimed that Thatcher had monetarist ideas even in the late 1960s (Wapshott and Brock, 1983, pp. 88, 187). But the Thatcher statements offered as evidence on this point are similar to those common among politicians at the time, i.e., she urged giving monetary policy greater weight among the tools used for demand management. The monetarist view of inflation was not present in Thatcher’s 1960s statements. But there is no doubt that the position on inflation taken by Thatcher and other senior Opposition personnel converged in the late 1970s toward the familiar monetarist one, and that the policy framework that the Conservative Party had on returning to office in 1979 was shaped by the monetarist position on inflation.

Thatcher’s own descriptions of the changes in party policy following her becoming leader have tended to give heavy acknowledgement only to Keith Joseph, who over 1974–79 was frequently identified as the leading proponent of “monetarist” positions in U.K. politics. For example, in 1997 Thatcher said: “We rebuilt the party, Sir Keith Joseph and I, after the defeat in 1974... and we transformed Britain from 1979 onwards.”¹⁹⁷ Joseph had said in 1974 in relation to Friedman: “the evolution of my views owes little to him.”¹⁹⁸ Since Thatcher acknowledged mainly Joseph, and Joseph denied a significant impact on his thinking to Friedman, acceptance of this version of events would imply that the Conservative Party adopted “monetarist” views in the later 1970s without appreciable influence from Friedman’s work!

More accurate accounts, however, indicate that there was an identifiable influence of Friedman’s ideas on Thatcher. It was Peter Jay, not Joseph, from whom Thatcher learned about monetarism for the first time (see Parsons, 1989, p. 200). Jay, as noted above, had been talking about Friedman’s ideas in his *Times* contributions starting in the late 1960s, and had from then on pushed the need for greater emphasis on monetary aggregates in U.K. policymaking. It was inconvenient for Conservative politicians to acknowledge an effect on their policies of Jay’s writings. Over and above politicians’ usual reluctance to acknowledge influences on their thinking, there was the consideration that Jay was a son of a member of the 1960s Wilson Government Cabinet, and was also, as previously noted, son-in-law of leading Labour figure (and, from 1976, Prime Minister) James

¹⁹⁷ Thatcher, London press appearance, May 2, 1997, broadcast on CSPAN on May 4, 1997.

¹⁹⁸ *The Economist*, September 28, 1974*b*; also quoted in Cockett (1994, p. 244).

Callaghan. To her credit, Thatcher did speak candidly at a 1977 press conference about the influence of Jay on her thinking. “We’re great friends, and I’ve been an economic disciple of his for years.” (*The Sun*, September 15, 1977.) As for Friedman himself, he is said to have first had detailed conversations with Thatcher in 1978 (Campbell, 2000, p. 372). These probably took place during his April 1978 visit to the United Kingdom.

Friedman, as discussed previously, was critical of the U.K. Conservative Party’s historical record on economic policymaking. The impact of his ideas on Conservative Party policy formation after 1975—which, Joseph’s denials notwithstanding, was widely understood—did not come in for universal welcome on the part of conservatives in the United Kingdom. The most well-known critics were Edward Heath and other Conservative Party advocates of incomes policy to fight inflation.¹⁹⁹ But other objections by conservatives rested on the fact that so much of the debate was being focused on economic policy formulation. One such objection was that the concentration on Friedman and on economists generally took the attention away from home-grown conservative thinkers, such as Michael Oakeshott, who had focused on non-economic issues (*Yorkshire Post*, May 31, 1990). A separate objection, coming from the budding neoconservative movement, was that the debate on inflation and other domestic issues was a distraction from what was claimed to be the growing prospect of a Warsaw Pact air/ground invasion of Western Europe (e.g., *The Times*, March 29, 1976; *The Times*, August 2, 1976).

In any event, the economic substance of Friedman’s arguments crossed party lines. As early as 1968, Robert Solow noted, “the association of monetarism with right-wing politics is not at all necessary.” (*The Times*, December 23, 1968.) Friedman’s own observations were in emphatic agreement with Solow’s assessment. For example, Friedman (1978a) argued: “No doubt there are strong ideological elements in the susceptibility of individuals, including politicians and their advisors, to persuasion by either the monetarist or Keynesian views. Yet the basic issue is scientific, not ideological... Whatever a man’s objectives, whatever his ideology, he can pursue them more intelligently the better he understands how the world works.”

¹⁹⁹ The projected companion paper covering 1980–2006 will deal in detail with Heath’s disagreements with Friedman, including those covered in their radio debate in 1980.

A specific scientific question underlay much of the U.K. political debate from 1974 onward. The issue was whether incomes policy was a valid weapon against inflation, or whether instead only monetary policy could accomplish disinflation. The outcome of this debate rested on the scientific question of whether inflation was a monetary phenomenon. One Labour-supporting writer recognized the scientific aspect to the debate in 1974, observing: "There is a danger that socialists will dismiss the monetarists' argument simply because that school of thought has hitherto been associated with right-wing conservatism. This is because the leading monetarist, Professor Milton Friedman, has some very eccentric right-wing views. But, in fact, the analysis of the rate of inflation is in no way related to ideological conservatism... Socialists will have to come to terms with this school of thought if we are to effectively fight inflation." (*New Statesman*, October 25, 1974.)

Governments of both political parties in the United Kingdom eventually assigned inflation control to monetary policy. This reflected not the triumph of ideology, but the fact that policymakers wanted inflation down, and had accepted that, as a technical matter, the only way this could be accomplished was through monetary policy. As Friedman put it, "It's not what I advocate that matters; there is only one way to do it." (*St. Louis Globe-Democrat*, December 16, 1977.)

That convergence of the political parties' positions had not yet occurred at the time that the 1979 U.K. general election was held. The Callaghan Government went to the election with incomes policy prominent in its platform, including a new union/government agreement on wages to replace the Social Contract, and plans to extend price control, while the Conservative Party under Thatcher rejected incomes policy in favor of a focus on monetary control. Friedman was in London during the early stages of the election campaign to give the Harry Johnson memorial lecture. A few days before the lecture, he was a guest at a Conservative Philosophy Group meeting, held at the residence of the colorful Conservative Member of Parliament Jonathan Aitken. To the disapproval of several of the Conservative MPs present, Friedman said that, on coming to office, Thatcher should abolish wage/price and exchange controls, cut the top income tax rate to 50%, and order an across-the-board cut of 5% in government expenditure. Aitken did not exactly fulfill the role of a gracious host when he chose to describe Friedman as a "brilliant elf" on being asked about their meeting by a newspaper (*Evening Standard*, April 6, 1979).

The Conservatives won the May 1979 election, and Thatcher became Prime Minister on May 4. Interviewed by BBC television shortly after the election, Friedman underlined the change in direction, both with respect to monetary policy and to the role of government, implied by Thatcher's coming to power. "If the Thatcher government succeeds," Friedman said, "it will be an example that will not be lost on the United States or the rest of the world."²⁰⁰

6. CONCLUSION

The U.K. banking periodical *Midland Bank Review* commented in its Summer 1979 issue on the implications of the change of government for the direction of economic policy. "The mantle of Keynes, and particularly the embroideries of his followers, appears to have worn thin; and the mode has shifted towards the sterner lines of thought popularized by Milton Friedman. The new Government comes to office in a climate of opinion very different from that which influenced its Conservative predecessor..." Nevertheless, Nicholas Kaldor was able to boast accurately that Friedman had "made comparatively few converts among academic economists" in the United Kingdom.²⁰¹ The support for Friedman's ideas was also thin among members of the new Government, once one looked below the most senior levels. In these circumstances, and despite his drawing of distinctions between his own positions and those of the Thatcher Government, Friedman would find himself a central figure in the debate over the new economic policies. In 1979 he was about to shift to an even higher profile in the United Kingdom and, in defending his positions on monetary policy and on the role of government, would encounter in debate some of the most formidable figures in U.K. economics and some of the biggest names in both major political parties.

²⁰⁰ 1979 television interview with Friedman; archival excerpt shown on BBC2, June 25, 1992.

²⁰¹ Kaldor (1982, p. xxii).

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