MILTON FRIEDMAN

- Friedman was born in 1912 at Brooklyn in New York, studies in Rutgers University passed out of Columbia University with Ph.D degree in 1946
- He was a prolific writer and an outspoken conservative thinker
- He is best known for his contributions to the monetary school, which holds that monetary rather than tax and fiscal policy is the most effective means of controlling inflation while keeping unemployment within acceptable means

1.quantity theory of money

- Friedman in his essay, "The Quantity Theory of Money-A Restatement" published in 1956 beautifully restated the old quantity theory of money.
- In his restatement he says that "money does matter"
- He says that his quantity theory is a theory of demand for money
- He distinguishes between 2 types of demand for money

-in the first type,money is demanded for transaction purposes. It serves as a medium of exchange.

-in the second type money is demanded because it is considered as an asset

- He considered money as an asset or part of wealth
- The demand for money depends on 3 factors

a)the total wealth to be held in various forms

b)the price or return from these various assets

c)taste and preference of the asset holders

- He considers 5 different forms in which wealth can be held, namely, money (M), Bonds(B), Equities (E), physical non-human goods(G), and human capital(H)
- Acc.to him there 4 factors that determine the demand for money . They are price level, wealth, rate of interest and expected rate of inflation

2.Permanent income hypothesis

- He rejects the use of current income as the determinant of consumption
- He divides the consumption and income into “permanent” and “transitory” components, so that

  Ym = Yp+Yt and

  Cm = Cp+Ct

Where Y stands for income C stands for consumption and m,p and t stands for measured,permanent and transitory components

- Permanent income is to be defined as the means of income which regarded as permanent by the consumer
- Measured income may be larger or smaller that his permanent income
- Difference between permanent income and measured income are due to the transitory component of income(Yt)
- If the transitory income is positive the measured income will be higher than the permanent income , if it is negative it will be lower than the permanent income
- If it is zero then measured income equals permanent income
- Thus according to him, actual consumption is related to “permanent income”
- Permanent consumption is a constant proprtion of permanent income

3.Friedman savage hypothesis

- Milton friedman and L.J.Savage in their well-known article, put forward a hypothesis that explains why the same group of people buy insurance and also engage in gambling
- In buying insurance they avoid risk and in engaging in gambling they take risk
- Acc. To this hypothesis, for most people MU of money income diminishes up to a certain level of money income, it increases from that level to a certain higher level of money income and then beyond that level it again diminishes

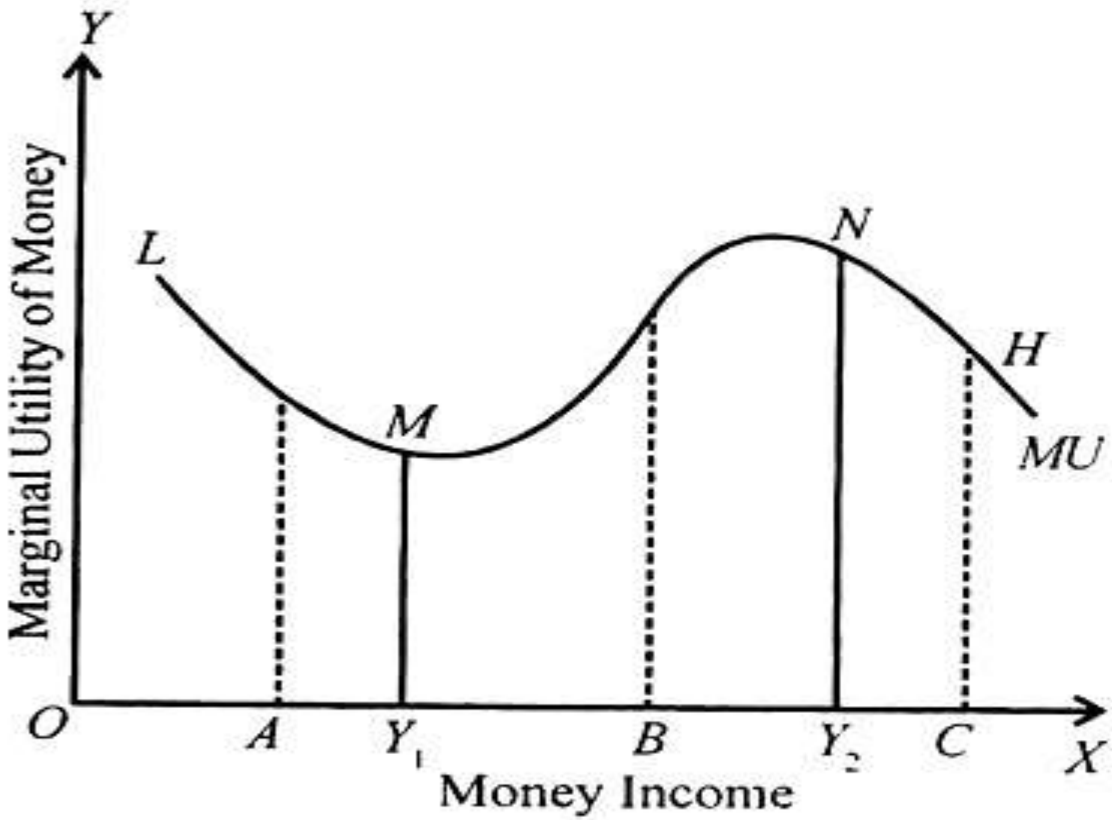

Fig. 12.