

*Ideas in the History of Chicago Economics  
Milton Friedman & Negative Income Tax*

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- ① Overview
- ② History of Ideas
- ③ Milton Friedman & Negative Income Tax

Many “Histories of Chicago Economics” discuss people, politics, ideology  
But I want to change focus

- Discuss *Ideas* and *Concepts* that have sprung from Chicago

Two Central Themes:

- ① Taking economics seriously
- ② Applying and testing economics empirically

*In discussions of economic science, Chicago stands for an approach that takes seriously the use of economic theory as a tool for analyzing a startling wide range of concrete problems, . . . that insists on the empirical testing of theoretical generalizations, and that rejects alike facts without theory and theory without facts. [1974 address to the University of Chicago Trustees. cf UofC Magazine Jan-Feb 2007, volume 99, issue 3]*

# Heckman's "Three Ground Rules for Chicago Economics"

Quoting from 2012 presentation at the Friedman Centennial Celebration

- ① Faculty know and understand the corpus of economic theory and economic empirical knowledge – not just their specialty within the field. *Students and faculty speak a common language – the language of basic price theory and the economics of incentives – and that we can communicate these ideas clearly.*

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- ② Chicago views economics as a serious subject, tackling serious problems.
- ③ Chicago economics demands that scholars move beyond selective and self-serving appeals to “stylized facts” to “illustrate” theories and instead engages and promotes the serious scientific task of careful and creative analyses of data, linking theory and evidence. Chicago values the hard empirical work that produces convincing evidence and rigorous economic theorizing that produces lasting contributions to important problems.

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# A History of Ideas – The Big Names & Big Ideas

- Thorstein Veblen: *Conspicuous Consumption*
- Frank Knight: *Risk vs Uncertainty (Ambiguity)*
- Jacob Viner: *Price Theory*
- Ronald Coase: *Externalities*
- Robert Fogel: *Economic History*
- Friedman: *Cons fn & perm income; Methodology; Monetary History; Phillips curve and NAIRU*
- T.W. Schultz: *Ag Econ; Human Capital*
- George Stigler: *Regulatory Capture; Economics of Information*
- Robert Mundell: *Optimal Currency Areas*
- Robert Lucas: *Rational Expectations*
- Gary Becker: *Human Capital; Economics of the Family; Discrimination*
- James Heckman: *Econometrics; Labor; Early Childhood*
- Lars Hansen: *Econometrics; Ambiguity*



# A History of Ideas – Lesser-Known Names

But also the ideas and some of the lesser-known names

- These are not the household names of Friedman, Becker, Lucas, Heckman. But it is because of these that Chicago is great
- Henry C. Simons: *Quantity Theory of Money*
- Paul Douglas: *Cobb-Douglas function*
- Wesley C. Mitchell
- Henry Schultz: *The Theory and Measurement of Demand*
- Law & Economics
  - Aaron Director: *Law & Economics*
  - Edward Levi
  - Richard Posner
- Trade and Open-Economy Macro
  - Harry Johnson, Larry Sjaasted, D. Gale Johnson (also Ag Econ)
- Labor & Applied Micro
  - H. Gregg Lewis: *Labor*
  - Jacob Mincer, Al Rees
  - Sherwin Rosen
- Econometrics
  - Henri Theil
  - Arnold Zellner
  - Zvi Griliches
- Regulation (Stigler)
  - Victor Zarnowitz
  - Lester Telser
  - Sam Petlzman
- Consumer & Home Economics
  - Margaret Reid , Mary-Jean Bowman

## PRICE THEORY

- Seatbelt & Peltzman Effect
- Thinking about economic decisions

Jacob Viner, to Friedman, Becker,  
Murphy

## MICROECONOMICS

- Revealed Pref & Axioms
- Mathematics of economic decision-making

Practical guides to some of the ideas:

- Human Capital (Gary Becker)
- Natural Rate of Unemployment (Milton Friedman)
- Permanent Income (Milton Friedman)
- Vignettes available at [www.hilerun.org/econ/chicagohistory](http://www.hilerun.org/econ/chicagohistory) (my site)

Heckman speaking at Harris 2017:

- Short clips:  
[https://www.youtube.com/watch?v=ivzCmrY\\_iAw&feature=youtu.be](https://www.youtube.com/watch?v=ivzCmrY_iAw&feature=youtu.be)
- Full: <https://www.youtube.com/watch?v=9N8GSDwGYzI&feature=youtu.be>

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# “Case for the Negative Income Tax” – 1968

*There is a far better way to guarantee a minimum annual income to all than our present grab bag of programs*

Modify standard income tax:

Income above Standard Deduction (\$24,400 for married)

Pay to Government – 10% for income just above SD

Income below Standard Deduction

Receive from Government – fraction of difference  $\tau \cdot (24,400 - E)$

Friedman proposes 50%

Total	<b>12,200</b>	<b>18,300</b>	<b>24,400</b>	<b>32,940</b>
Earn	0	12,200	24,400	36,600
Gov Pay	12,200	6,100	0	-1,220

# Negative Income Tax = Universal Basic Income

Net effect: Universal Basic Income (“Universal Subsidy” or “Social Dividend”)

- Even if earn zero, get minimum \$12,200 ( $\$24,400 / 2$ )
- Guarantees Minimum Income to everyone
  - Adjust Standard Deduction to adjust Minimum Income
- Friedman argues using tax system to administer is effective & efficient

# Friedman's Arguments in Favor

Friedman argues

- Simplifies current grab-bag of benefits
- Uses existing tax system
- Provides incentive to work (get to keep 50% of any earnings below \$24,400)

Arguments based largely on economic efficiency

- Government supports “poor” and transfers income
- This is more effective and efficient method
  - Uses cash rather than “in-kind” (e.g. Food Stamps (SNAP))
    - Strong argument to let *individuals* make their own rather than gov't saying “spend on food, ...”
    - Partly addressed since 1968
  - Uses existing income tax system
    - Reduces bureaucracy (cost)
    - Reduces temptation to use programs for other political ends

# Contrast with EITC (Earned Income Tax Credit)

EITC enacted 1975, expanded since

One of the largest US anti-poverty programs

Sounds like a Negative Income Tax (and is in some respect)

- Negative tax rate on *wages* rather than income

Does *not* provide UBI – excludes those who don't work

- Positive: provides incentive to work (“deserving poor”)
  - Politically easier
- Negative: does not help those who do not work
  - Displaced workers, out of work due to “globalization”



# Incentive Issues – *Don't Remove Incentive to Work*

Problem with “Lump Sum” Welfare Payment: removes incentive to work

Pay Min \$24,400 always

The “Negative Tax Rate” of 100%:  $\tau \cdot (24,400 - E)$

Total	<b>24,400</b>	24,400	24,400	<b>35,380</b>
Earn	<b>0</b>	12,200	24,400	36,600
Gov Pay	<b>24,400</b>	12,200	0	-1,220

NO incentive to work unless earn above 24,400

Pay Min \$24,400 but 50% (negative) tax rate

Increase Standard Deduction to \$48,800

Total	<b>24,400</b>	<b>30,500</b>	<b>36,600</b>
Earn	0	12,200	24,400
Gov Pay	24,400	18,300	12,200

Incentive to work – total increases with earnings (but effective **50% tax rate!**)

Both Negative Income Tax & EITC address this problem

- Major advantage of EITC over earlier programs