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Abstract. Few 20th century economics departments influenced the discipline as much as the University of Chicago. Among the oldest economics departments, its most distinguished characteristics are its high profile emphasis on market solutions, the colorful figures it attracted and developed, and those it retained. None have attracted the prolific and novel research that went on to win The Sveriges Riksbank Prize in Economic Sciences in Memory of Alfred Nobel.

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1. Introduction

For Few 20th century economics departments influenced the discipline as much as the University of Chicago. Among the oldest economics departments, its most distinguished characteristics are its high profile emphasis on market solutions, the colorful figures it attracted and developed, and those it retained. None have attracted the prolific and novel research that went on to win The Sveriges Riksbank Prize in Economic Sciences in Memory of Alfred Nobel. Since its founding, twenty-nine Chicago students, researchers, and faculty have received the Nobel Prize in economics, including the most recent winner, Richard Thaler. It is against this black-drop that Lanny Ebenstein has written his sixth book on the University of Chicago’s economics department with *Chicagonomics: The Evolution of Chicago Free-Market Economics*.

Every generation of economists interprets the two pillars of economic thought, Adam Smith and Karl Marx. For Smith, such interpretations vacillate between unbridled reliance on market outcomes (Stigler, 1977) to near democratic socialism (Offer & Söderberg, 2016). For Marx, interpretations have less variance, but his followers are on the opposite end in their views toward market outcomes (Colander & Klamer, 1987). The trajectory is clear. The most persuasive voice in economics that controls the reinterpretation of Smith and Marx reflects the narrative of the discipline, and throughout the 20th century, no other leading economics department came to be seen as the proper air to the Smithian free markets approach as the University of Chicago.

The University was founded in the late 19th century when, as a beneficiary of John D. Rockefeller’s wealth, Alvin Harper collected a host of scholars with an objective of the highest quality research and teaching (Van Overtveldt, 2007). The department has gone through four periods that reflected and influenced the economics discipline: its founding, the Viner-Knight period, the Friedman-era, and the post-Friedman-era. Since its inception, the economics department has never

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maintained a monolithic, single perspective. Nonetheless, its first chair, James Laurence Laughlin, was a conservative economist and strong supporter of the Gold Standard, which initiated the department’s reputation for a right-leaning, conservative economics department. Despite the appointment of Thorstein Veblen to its faculty, early leaders in the department extended this perception of conservative thought. It was Jacob Viner, Frank Knight, and Henry Simmons who were prominent figures in the early Chicago School. The Canadian economist, Jacob Viner, was most associated with trade but was also foundational in teaching microeconomics. Viner’s early influence on the department was pervasive and was identified as an early market liberal, which went on to influence the discipline with his work in international trade and producer theory. His influence evolved into the Chicago perspective in price theory. Under Viner, microeconomics was not an exercise in mathematical eloquence but an ‘engine of analyses’ used in understanding real world phenomenon. During his early career, Viner gained the reputation for being hard on students who were not up to his expected rigor; nevertheless, the influence he had on those who withstood his criticism—which included Milton Friedman and George Stigler—was profound. Viner left Chicago for Princeton in 1946.

Frank H. Knight was a second scholar associated with the early Chicago School, whose primary contributions were his book *Risk, Uncertainty, and Profit* and the influence he had on his students and department culture. Knight was a throw-back to the period when the discipline’s roots were not far removed from its academic parent in philosophy. After a brief foray into graduate studies in philosophy, he was advised by his philosophy professors that their discipline was not for him, and he changed his emphasis to economics. After earning his bachelor’s degree at Milligan College in Tennessee, Knight studied economics at Cornell University. This appreciation of philosophy reinforced his support of free-will and choice, which later justified research efforts by Friedman, Becker, and the rational choice school. However, Knight cannot be narrowly classified into supporting mathematically modeling of human behavior. In the absence of a mathematical and econometric methodology, Knight remained philosophical and a polymath. His influence on the department’s culture was consistent with the wider approach that became known as the Chicago School and its support for market solutions. An early student of Knight’s was Henry Simmons, who studied financial markets, corporate finance, and the business cycle. Nonetheless, members of this early trio were not collegially linked with a shared sense of direction but were connected by their commitment to market advocacy and laisse-faire outcomes.

For at least a time during the 1930s, it was not clear which direction the University of Chicago would take: state intervention or markets. When Keynes proposed activist government policies to correct imbalances during prolonged periods of economic downturns, he proposed either activist monetary or fiscal policies. Several early Chicago economists were inclined to resort to government spending and tax cuts before Keynes, and his initial policy prescription was to increase output through robust monetary policy and not to rely too heavily on government spending. During periods of severe economic crisis, even the most noted Chicago economists have advocated that government had an active role to steady the economy, both during the 1930s and early 2000s. However, Keynesian advocates were more comfortable with long-term government involvement than most Chicago economists. Austrians were at the other end of the interventionist spectrum and maintained that markets, left to themselves, best remediated economic cycles. Nevertheless, as distance and hindsight separate us from the Great Depression, the Austrian view of no-government intervention came to be seen as the Chicago response to cycles. A key difference between the Keynesian and Chicago views is that the policy be short-term, lest both the market and government become too reliant on the presence of a larger state role.

The Cowles Commission was a positive contribution to the University of Chicago’s early methodological diversity. Alfred Cowles was an economist,
businessman, and benefactor who established the Commission to advance the study of mathematical economics and econometrics. Originally established in the 1930s at Colorado State University, the Cowles Commission transferred to the University of Chicago in 1939. However, himself a competent statistician, Milton Friedman soon came to oppose the Cowles Commission methodological direction. According to Friedman and his followers, the Cowles Commission was largely technique in search of a question. The Cowles Commission soon tired of the Chicago climate and relocated to Yale University in 1955, but not before forever changing both the Chicago economics department and the disciplines’ methodological direction. Associated with 13 future Nobel Prize and a dozen presidents of the American Economic Association, the Cowles Commission’s principle objective was to integrate quantitative theory with evidence.

Milton Friedman is without question the most influential member of the University of Chicago economics department, and his 1946 arrival ushered in the Friedman-Chicago era, which lasted through his retirement in 1977. The Friedman-era extended and strengthened the perception at the University of Chicago that free markets were the best way to organization production, relied on the quantity theory of money, and was skeptical toward rigid enforcement of antitrust laws. The Friedman-era also developed a strong requirement of methodological empiricism. Others were important in establishing the Friedman-Chicago economics view. George Stigler returned in 1950 to emphasize industrial organization, search costs, and skepticism toward government regulation, which solidified the second generation of Chicago economics. Allen Wallis was an economist and statistician who served the National Resource Committee and Office of Scientific Research and Development during World War II. Wallis’s primary contributions were the application of statistical methods to economic relationships, and he went onto become Dean of the University’s Graduate School of Business and later a presidential advisor in the Eisenhower, Nixon, Ford, and Reagan administrations.

Aaron Director was a key figure in the Friedman-era development of Chicago’s law and economics. Before Director and Stigler, tacit actions to acquire and maintain market power were perceived to plague the US economy. Director’s contribution to the Friedman-era was proposing the appropriate legal and institutional framework for a competitive market system. Over time, Aaron Director and George Stigler found there was sufficient competition in US output markets, and antitrust and excessive regulation could themselves be used to create market power. Subsequently, Milton Friedman, George Stigler, Allen Wallis, and Aaron Director formed the bulwark of what later was the Chicago school of free-market economics.

Nevertheless, the University of Chicago’s contributions extend beyond the Friedman-era. Gary Becker revolutionized labor economics, time allocation, and the economics of the family. Ronald Coase was foundational to contract theory, law and economics, theory of the firm, and externalities. Kevin Murphy does important work in labor economics and the distribution of income. Lars Peter Hansen considers the linkages between the financial sector, macroeconomics, and revolutionized econometrics with Generalized Method of Moments. James Heckman’s work in econometrics, labor economics, and early childhood development changed economics. Eugene Fama’s studies in financial economics are instrumental with the efficient market hypothesis, market indexing, and asset pricing.

By any measure, Chicagonomics is not an objective economic history of one of the most prolific economics departments at the height of its influence, and readers from academic and popular audiences drawn to traditional Chicago School economics will be frustrated. A key distinction throughout the book is between classical liberalism and Libertarianism, and an underlying policy question is the proper role of the state, with particular attention devoted to a progressive income tax. Throughout the text, Ebenstein defines classical liberalism where Smith, Mill, and Keynes—even early Friedman and Hayek—see a progressive role for the state
to remediate inequality, ameliorate market imperfections, and reduce spillover effects. Ebenstein concedes Friedman as the University of Chicago’s faculty member who had the greatest role in formulating what is now considered the Chicago view of economics. However, Ebenstein’s identification of Friedman and Hayek’s later views caricature them as neo-conservative, anti-government extremists that had no interest in a better understanding public policy whose positions evolved after weighing evidence. Moreover, when the older Friedman defined classical liberalism as “Nineteenth-century liberalism favors private enterprise, and a minimum of government intervention,” Ebenstein and the historians he references disregard Freidman’s evolution and caricature his later views to reject modern Libertarianism. Furthermore, contrary to Ebenstein’s advocacy for progressive taxation, Freidman in Capitalism and Freedom (1962) advocated a flat tax because the rich take advantage of numerous loopholes, which nullifies the redistributive effects a progressive tax is meant to correct. Subsequently, much of the book is an effort to redefine debatable terms to make the most important figures in the Chicago School’s development more palatable with contemporary liberalism. The University of Chicago has always been diverse. Friedman and Hayek evolved, but Chicagonomics devotes excessive space and effort to rejecting Libertarianism that could have been devoted to flushing out principle figures in the School’s development. For example, contributions from Becker, Coase, Murphy, Hansen, Heckman, Posner, and Fama are not discussed. These omissions alone are sufficient to render the study incomplete.

In terms of sheer influence, few contend that the 20th century’s University of Chicago’s economics department had a leading role in the development of modern economics. Throughout its development, the department had a host of diverse views—as Richard Thaler’s 2017 Nobel Prize in behavioral economics attests. There is now a cottage industry either supporting or refuting the ideas of the University of Chicago and its early prominent contributors. In the end, Chicagonomics offers general readers an alternative view toward the leading figures in the establishment of the University of Chicago.

References