

The University of Chicago
A Proposal to Establish
The Milton Friedman Institute

Introduction

In May 2007, President Zimmer and Provost Rosenbaum appointed an ad hoc committee “to consider the possibility of creating a major new institute at the University on economics and society.” The committee members, drawn from the Department of Economics, the Graduate School of Business, and the Law School, were asked to “consider the major programmatic goals and activities of the institute and mechanisms for achieving them; how the institute might be organized, including its relationship to new or existing centers or institutes; and to the extent possible, [to] comment on governance issues and resource, space, and staffing needs.”

The ad hoc committee has considered this charge and has found that the University has an unusual opportunity to leverage the intellectual resources and collaborative nature of the Department of Economics, the Graduate School of Business, and the Law School to create one of the world’s most vital and visible institutes for economic research and policy analysis and evaluation. To realize this goal, the University will need to invest significant new resources to establish and house a major new institute and to provide ongoing funding for a robust fellowship program that will attract the world’s leading and most promising scholars and policymakers to Chicago. A commitment of the highest level to the vision outlined in this proposal will build on Chicago’s singular reputation for economic research and will ensure that in the generations ahead Chicago will extend its reputation as the most attractive place for scholars and students interested in rigorous economic analysis and policy evaluation.

Over the last century, the University of Chicago has helped define the field of economics and has demonstrated the value of economic theory in understanding and approaching a broad array of important societal questions. Milton Friedman typified and became emblematic of the “Chicago School” of economics until his death one year ago. In Friedman’s statement on *The Chicago School of Economics*, he reflected on the special attributes of economics at Chicago:

In discussions of economic science, ‘Chicago’ stands for an approach that takes seriously the use of economic theory as a tool for analyzing a startlingly wide range of concrete problems...for an approach that insists on the empirical testing of theoretical generalizations and that rejects alike facts without theory and theory without facts. ...

There are really three aspects of the Chicago school. First, it is distinguished by its scientific approach, its attitude toward economics as a discipline, a science. In the second place, it has a distinctive approach to economic policy in general. And third, and more recently, it has had a special meaning in the field of monetary analysis and monetary policy...

The most important aspect, in my opinion, is the scientific. The key to the influence of The University of Chicago on economics throughout the world is that ever since its founding in 1892, the Economics Department of The University of Chicago has regarded economics as a serious subject that has something to do with the real world. It has considered economics a positive science, a method of analysis which has broad applications to many topics.

The institute that the committee is proposing would build on this important tradition by investigating research questions related to economic policy through the use of formal economic models with explicit empirical underpinnings. Following Friedman's lead, the design and evaluation of economic policy requires analyses that respect the incentives of individuals and the essential role of markets in allocating goods and services. As Friedman and others continually demonstrated, design of public policy without regard to market alternatives has adverse social consequences.

The intellectual focus of the institute would reflect the traditions of the Chicago School and typify some of Milton Friedman's most interesting academic work, including his seminal work on the permanent income theory of consumption, his critical analysis of monetary policy, and his advocacy for market alternatives to ill conceived policy initiatives. This connection of the proposed institute to the legacy of Milton Friedman's intellectual contributions provides a special opportunity to recognize the distinguished place held by Friedman at Chicago and throughout the world. We recommend naming the institute The Milton Friedman Institute to honor Friedman's legacy and to indicate how the work of the Institute will, like the work of Friedman, have a deep influence on economic theory and policy around the globe.

The Opportunity at the University of Chicago

Inspired by Friedman's legacy, we propose to create an Institute that features economic research at its best: rigorous development of economic models supported by empirical evidence and designed to address questions with important social and economic consequences.

The field of economics is becoming increasingly specialized. While this is a natural development as the discipline advances, it has its adverse consequences. Specialization leads to focus and segmentation, but in a manner that can be counterproductive. It runs counter to Friedman's own vision of research. Indeed, Friedman's famous work on the permanent income theory of consumption drew on previous theoretical insights of Irving Fisher and others and on the comprehensive research of the empiricist Margaret Reid (also at Chicago). The resulting contributions developed the precursor to modern models of consumption-savings decisions relevant for both macroeconomics and microeconomics. In part his aim was to provide a framework for integrating microeconomic and macroeconomic evidence on consumption and savings behavior as a crucial input into the study of the macroeconomic economy. To understand the role of macroeconomic policy, he worked with Anna Schwartz to develop a comprehensive history of monetary policy, while at the same time appealing to modern statistical decision theory and its limits as a practical guide to policy making. He collaborated with the eminent statistician Leonard Savage in seeking an explanation for how wealth influences risk-taking

behavior. His work on monetary economics set the stage for the rigorous use of game theory in characterizing optimal macroeconomic policy. Milton Friedman's intellectual legacy crossed many boundaries of economics that are now becoming well defined subfields. Economics at Chicago has nurtured this interaction and resisted an excessive pull towards specialization. This aspect of Chicago economics draws inspiration from Friedman's example.

We see the Milton Friedman Institute as critical for preserving and fostering the strong tradition of Chicago economics broadly conceived. It will serve two important functions. First, it will provide resources to continue to recruit and retain top scholars. Some of the most outstanding economics departments, business schools, and law schools that we compete with are housed in universities making substantial investments in infrastructure to support economic research. Chicago economics requires at least comparable resources to those of our top competitors. Stanford has the Stanford Institute for Economic Policy Research (SIEPR) with resources available to support research with policy ambition. Yale has the Cowles Foundation that funds some of its best faculty and distinguished visitors. In spite of severe budgetary pressures, The University of Minnesota has developed explicit ties with the Federal Reserve Bank of Minneapolis to support faculty in macroeconomics by creating an ambitious program of visitors. University College at London has an associated Institute for Fiscal Studies that has promoted the development of microeconomic evidence as essential input into credible policy analysis. This Institute has been critical in establishing the UCL as a leading economics group in Europe. Finally, economics at Harvard and MIT benefit extensively from the National Bureau of Economic Research (NBER) in Cambridge, Massachusetts. The NBER has a separate space near Harvard University that houses visitors, graduate students, and affiliated faculty from Harvard and MIT. Its support of research activities is a central reason for the continued success of Harvard and MIT in recruiting first-rate faculty and producing top graduate students. The Friedman Institute at the University of Chicago will preserve and indeed significantly enhance Chicago economics by supporting research ambitions of some of its best faculty and help us to compete in recruiting top scholars of various vintages.

Second, we see the Friedman Institute as a means to encourage interaction across some of the best and most exciting areas of research in economics and related disciplines. It is unrealistic to hope that economics at Chicago can be excellent at all subfields. It has not been true in the past and we cannot expect it to be true in the future. To preserve the vibrant research character of economics at Chicago, it is crucial that we have access and exposure to the best research and scholars around the world. Our aim is to design this Institute to be one that external scholars will find attractive to visit and where they will find value in sharing their research with local scholars. It will give us a way to continue to learn about the best new research in a variety of areas and to seek cross fertilization across important subfields of economics. It will help us break down intellectual barriers by giving experts the support required to play leading roles to run workshops during extended visits and to recruit complementary younger visitors to the Friedman Institute. Thematic workshops over extended periods of time will allow us and our colleagues to explore potential research synergies through repeated dialog and exposure to promising lines of research. By rotating themes we can continually explore the most important new research contributions in economics, and we can seek ways to broaden the scope of this research when appropriate. For these benefits to be realized, it is important that the Friedman Institute become a place where top scholars want to visit even if the scholars do research in areas in which Chicago economics is not

well represented. Senior scholars will need the resources to attract junior colleagues, post doctoral fellows, or advanced graduate students. A main obligation of these scholars will be to participate actively in exploring the potentially broader impact of their research and to investigate how this work might complement other research at the University of Chicago.

An institute designed with these two aims will allow Chicago to maintain leadership in the field of economics and continue in its ability to resist artificial separation into research clubs spawned by excessive specialization.

While the committee views the establishment of the Friedman Institute as an exciting opportunity, we also see this type of investment as a necessity if the University is committed to building on its tradition of leadership and influence in economic research. Without such support the high level of excellence of “Chicago economics” that has existed in the past will be in danger of being undermined by the loss of top scholars and the inability to make new appointments with distinctive scholarly trajectories.

Historically there have been important intellectual links between the Economics Department, the Graduate School of Business, and the Law School. Economics on campus has benefited not only from the distinctiveness of the Economics Department but also from the strong intellectual tradition relating economics to core research activities in the Graduate School of Business and the distinguished tradition of law and economics within the Law School. The current lack of a University supported structure for collaborative work with the Department of Economics, the Graduate School of Business, and the Law School threatens the strength of the connections among these three units; the limitations of our facilities restrict program growth and hinder informal interactions and collaborations that often lead to innovative teaching and scholarship; and our inability to access adequate funding for a fully developed visitors program, fully competitive graduate student support, and fully competitive faculty research support, at a time when our competitors are making significant resources available in these areas, threatens our ability to recruit leading scholars and maintain the University’s reputation as the most dynamic place for economic study and research. The Friedman Institute, if fully realized, would provide the infrastructure and financial support to mitigate these threats.

The Core Activities of the Institute

Economics at Chicago has been distinguished by the quality of its faculty and students, its connections to government, law, and business, its rigorous approach to economic analysis supported by empirical evidence, and its culture of innovation derived in part by a system of workshops and working groups through which new ideas are tested and critiqued. The Applications Workshop and the Money and Banking Workshop have long histories of being important places for the discussion of a diverse array of important topics in economics. (Milton Friedman himself endowed the latter workshop with a reputation for high scholarship when he ran it.) Similar workshop fields such as finance, econometrics and statistics at the Economics Department and GSB, and law and economics at the Law School, provide a shared intellectual foundation from which to construct the Friedman Institute. The Workshop on Rationality started many years ago by Becker and Coleman explores synergies across a wide arena of research in

social sciences and, founded more recently, the Chicago Workshop on Black-White Inequality examines inequality of education, income, health, and family structures by bringing together leading scholars from across the University and from universities around the country.

Creating workshops with specific purposes

The committee proposes that the Friedman Institute support and build on the existing research foundation by developing several categories of visitors who would regularly populate the Institute and lead or participate in workshops, teaching, and research, thereby bringing fresh perspectives to the University and invigorating the intellectual climate of economics at the University of Chicago. While we have sufficient general purpose workshops, we aim to develop rotating workshops focusing on alternative themes that both support and complement research on campus. An example of topics includes the design of monetary or tax policy in a complex and uncertain environment. This would update an important area of Friedman's own research while providing an opportunity to explore both conceptual issues and practical issues of implementation. This research features both the construction of dynamic stochastic equilibrium models rich enough to pose interesting macroeconomic policy problems and a formal statement of how the private sector interacts with a government. Both macroeconomic time series and microeconomic evidence offer challenges for model development, and the forward-looking purposeful behavior on the part of individuals and governments implies important constraints on the design of policies that have hopes of achieving productive outcomes. Workshops would explore in detail some of the component research ingredients and policy questions including the role of monetary policy in mitigating financial distress or the role of tax policy in fostering economic growth. To have an impact, specificity is needed for individual workshops but alternative components could be explored over time with an aim towards exploring more synergistic interactions across research themes. While the University of Chicago has considerable expertise in this area, there is much to be learned from research done elsewhere, including economics departments and research departments in the Federal Reserve and other central banks.

An additional area of potential inquiry is the interaction of decentralized markets for credit and insurance and the design of public policy in both developing and developed economies. This poses important challenges in model building and solution, along with challenges in estimation and testing required for empirical credibility. It could explore research commonalities that occur in the study of investment in both human and financial capital and it could investigate how policies can best be designed to complement decentralized markets. Confronting the best empirical evidence from a variety of sources and exploiting some of the best modeling advances will result in productive workshop activities. There are a host of other related topics that would be fruitfully explored in a sequence of workshops with rotating themes. Such activities will be most rewarding when they cross the narrow boundaries of subfields within economics.

A third example of an area for exploration would be to understand how the quality of government institutions influences economic growth. Workshops could explore how legal traditions such as judicial institutions, constitutional norms, and law enforcement practices alter trajectories of economic development and social outcomes. This is but one example of a law and economics topic that would harness the capacity of the Law School alongside that of the

Economics Department and the GSB, although the more so if infused with the input and special knowledge of visitors to the Friedman Institute.

To support these and other activities we suggest the creation of a very active visitor's program that would attract and reward scholars at different stages of their careers. Senior distinguished scholars selected as visitors to the Friedman Institute would be given lead roles and resources to bring in complementary younger faculty, post docs, or graduate students. Distinguished scholars recruited to collaborate on work or lead a workshop would be given flexibility in terms of their visiting appointments (with flexibility being especially important in attracting senior scholars). While we would be outward looking, we would include the possibility that distinguished local faculty would visit the Friedman Institute to play lead roles in workshops and recruitment of other scholars.

The ability to attract multiple scholars at the same time will enhance the success of this venture and make it possible to recruit the best researchers. The Institute will become a leading intellectual center in economics and will create an exciting, dynamic environment for a wide range of scholars and students. To complement the workshops, there would be featured lectures or conferences designed for senior policy experts and a broader audience of people interested in Institute activities. For instance, Federal Reserve Regional Presidents or members of the Federal Reserve's Board of Governors would be natural to include in discussions of questions that bear directly on monetary policy. At the same time it would be necessary to provide resources to support some of the core research done by the visitors to the Institute and scholars on campus.

An important side benefit of the Institute is that it could help attract top senior colleagues to the University on a permanent basis and identify younger scholars who are likely to develop into intellectual leaders in the future. This benefit will be realized by enhancing the research environment and giving the University an alternative recruitment forum.

Nurturing young scholars

Post doctoral fellowships in the field of economics are unusual. Students typically go on the job market for assistant professorships right out of graduate school. Specialization in the field of economics is reflected in graduate student training. Given immediate teaching obligations and pressures to publish, the young scholars have little opportunity to broaden their training and interests in their first years out of graduate school. We propose to combine the best elements of a post-doctoral appointment with an assistant professor appointment. We would recruit new Ph.D.s who show special promise and who will benefit from a fertile environment for scholarship. The aim would be to start off such a position as a highly attractive post doctoral fellowship relieved of teaching duty and other departmental obligations, but have the position evolve into an assistant professorship. Top prospects would be made post doctoral fellows of the Friedman Institute for two years prior to initiating the teaching component of their career at the University of Chicago. This would allow the promising scholars to expand their array of research skills and interests. For this program to be successful, the post docs would have to be compensated at a level that becoming a fellow of the Friedman Institute would be looked upon as a dominant alternative to becoming an assistant professor. These young scholars would be active participants in workshops and in some cases play important roles in leading the workshops. This

program would provide a comparative advantage when recruiting top young scholars to the University of Chicago.

Supporting graduate student research

We envision three activities to support graduate students. The first would be the provision of University of Chicago graduate student dissertation fellowships, which would allow advanced graduate students from across the University to be in residence at the Institute to conduct independent research, collaborate with faculty and visitors, and participate in the intellectual life of the Institute. These Fellowships would be among the most prestigious available at the University. The second activity would support students who seek a joint J.D. and Ph.D. in economics, or more generally to support economics students who would like to spend a year taking classes and attending workshops at the Law School, and learning about law and legal institutions. Such support could be expanded to include other substantive areas that are complementary to economics. The third activity would offer summer fellowships for advanced graduate students that would bring the most talented students from around the world to Chicago each summer for a shorter stay, similar to the way that highly accomplished students in the biological sciences are attracted to Woods Hole. This program could build on the successful Institute for Computational Economics, a joint effort of the University of Chicago and Argonne National Laboratory, but be directed towards fostering some of the best quantitative research designed for policy analysis. This would allow the Friedman Institute to encourage top scholarship at the important early stages of research development and foster a community of young scholars throughout the world with common research interests.

Supporting undergraduates with research ambitions

Economics is the dominant concentration among undergraduates on campus, and there is impressive talent among the very best students. We advocate internships or fellowships for University of Chicago College students, encouraging some of our best undergraduates to work closely with a faculty member, visitor, or advanced graduate student on research projects. In addition, Friedman Awards for the best undergraduate theses would help support our most talented undergraduates with research ambitions.

The activities described above would have a dramatic effect on faculty and student recruitment. These programs can be used both as explicit recruiting devices for outside scholars and as devices to foster and encourage some of the best economics research among scholars currently on campus. There is also very strong potential for the Institute to leverage the influence of existing centers on campus by joining with those centers for joint programs and fellowships. Over time, the Institute might naturally develop a set of affiliated centers that help provide structure for research in subfields of special import.

The Friedman Institute would benefit from a regular effort to disseminate the work of associated faculty and visitors. The potential is great for raising the visibility of the Institute and extending its influence by making publicly available the research and policy analyses derived from workshops, talks, and the ongoing work of scholars and policy makers associated with the

Institute. The Institute would need a strong web presence and communications staff to disseminate this work in a timely and regular manner.

Governance and Administration of the Friedman Institute

The committee would expect the Institute to operate collegially, meeting the broad needs of faculty and students by sharing decision making through a relatively flat organizational structure. Nevertheless, we recognize the importance of recruiting an outstanding Director of the Institute, who would work closely with faculty in developing programs and who would play a lead role in securing ongoing resources for the Institute.

We recommend that the Institute develop an internal faculty board of advisors, perhaps drawn initially from this committee, to advise the director on programmatic direction and to oversee the selection of visitors.

The Institute would be served well by establishing a visiting committee comprised of leading scholars, policy experts, and friends of the Institute. This group, which would meet no more than once or twice a year, would offer suggestions for new directions for the Institute to explore and offer high level guidance on the operations of the Institute.

We recommend exploring the possibility of creating a Milton Friedman Institute Founders Society of the most generous friends and supporters of the Institute. This group would receive regular news and publications from the Institute, would be invited to an annual lecture and dinner, and would provide financial support at a level that would ensure the long-term success of the Institute.

The success of the Institute is also dependent on adequate resources to allow faculty and visitors to focus on their research and for the director to be able to focus on the intellectual direction and resource needs of the Institute. There is considerable work in recruiting and housing scores of visitors each year and publishing proceedings of workshops, talks, works-in-progress, and the like. There will need to be adequate administrative, clerical, and communications/publications support to allow the director, visiting fellows, and associated faculty to focus their time on the core scholarly activities of the Institute. A more highly developed plan for the Institute will also need to take into account the need for core research support both in terms of staffing and computing facilities.

Space Needs

It is critical that space be identified for the Institute that has adjacency to the Department of Economics and close proximity to GSB and the Law School. The strength of the Institute depends on the regular interaction of a diverse group of scholars. The space must facilitate this interaction through shared seminar and meeting rooms, visitors' offices, café or dining spaces, lecture halls, large gathering spaces, and lounge areas that encourage informal discussion.

We would also expect for the Friedman Institute to house the infrastructure to support faculty research. (One example of such infrastructure would be computing capacity.)

Further detail on space needs is contingent upon the specific program that needs to be accommodated. We will defer development of this section until we have estimated the number of potential scholars and students in residence at any given time, agreed on the likely number of support staff and technical infrastructure required, and detailed the programmatic goals of the Friedman Institute.

Estimated Resource Needs

Based on the experience of other Institutes that house robust visitor programs, we anticipate needing the following levels of support (with the understanding that a much more detailed analysis is needed to develop an estimated budget for the Institute):

- \$2m to \$4m annually to support visitor stipends/fellowships
- \$300,000 annually to support workshops, dissemination of workshop proceedings, and other direct program support
- \$400,000 annually to support administrative and core research support staff
- \$300,000 annually to support computing facilities; data creation, organization and analysis; and the ongoing technology and facility needs of the Institute.
- Endowed funding for the Directorship of the Institute
- Endowed rotating research chairs, which would be housed in the Institute
- Funding to support the renovation or construction of space for the Institute

Concluding Thoughts

Milton Friedman once described the Economics Department at Chicago as “a venturesome department...[which] pushed out the frontiers in a variety of directions.” He noted “that no other major university has consistently had so wide a spectrum of views represented on its economic faculty as has Chicago.” In his view, “The University of Chicago is characterized by diversity in every dimension, by a willingness to experiment, to judge people by their performance rather than their origins, to judge ideas by their consequences rather than their antecedents.”

While Economics at the University of Chicago has a proud and illustrious history, it is vital that we be forward-looking. Our aim is to produce a future legacy with its own distinction. The Friedman Institute will enhance our current research environment by embracing initiatives that pursue thoughtful agendas and sustained efforts and shun superficial answers to important economic questions. The Friedman Institute will encourage the production of durable analyses that can withstand the highest level of scrutiny and be supported by the best modeling and most informative empirical evidence. While addressing important economic and social problems, it will provide the impetus for rigorous analyses in support of creative approaches to research.

How can this Institute best support the development of a new legacy of Economics at Chicago? It will help us attract the best faculty to campus with a shared goal of excellence. It will broaden the intellectual landscape by supporting explorations of new lines of research currently not represented on campus. It will provide our departments and schools with the resources to compete with other top institutions and give us the best opportunity to maintain and build on past successes. It would serve as a foundation for new leadership by providing a distinctive intellectual environment that encourages discourse and synergies across a variety of research areas, that fosters ambitious research agendas, and that promotes criticism and scrutiny as a device to maintain excellence.

The establishment of The Milton Friedman Institute would ensure that the singular position of Chicago economics over the last century would serve as a foundation for continued leadership in shaping fields of thought as well as economic and social policies throughout the world.

For the Committee:

Lars Peter Hansen, Committee Chair, Homer J. Livingston Distinguished Service Professor in Economics

Gary Becker, University Professor, Departments of Economics, Graduate School of Business, and Sociology

John H. Cochrane, Myron S. Scholes Professor of Finance, Graduate School of Business

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