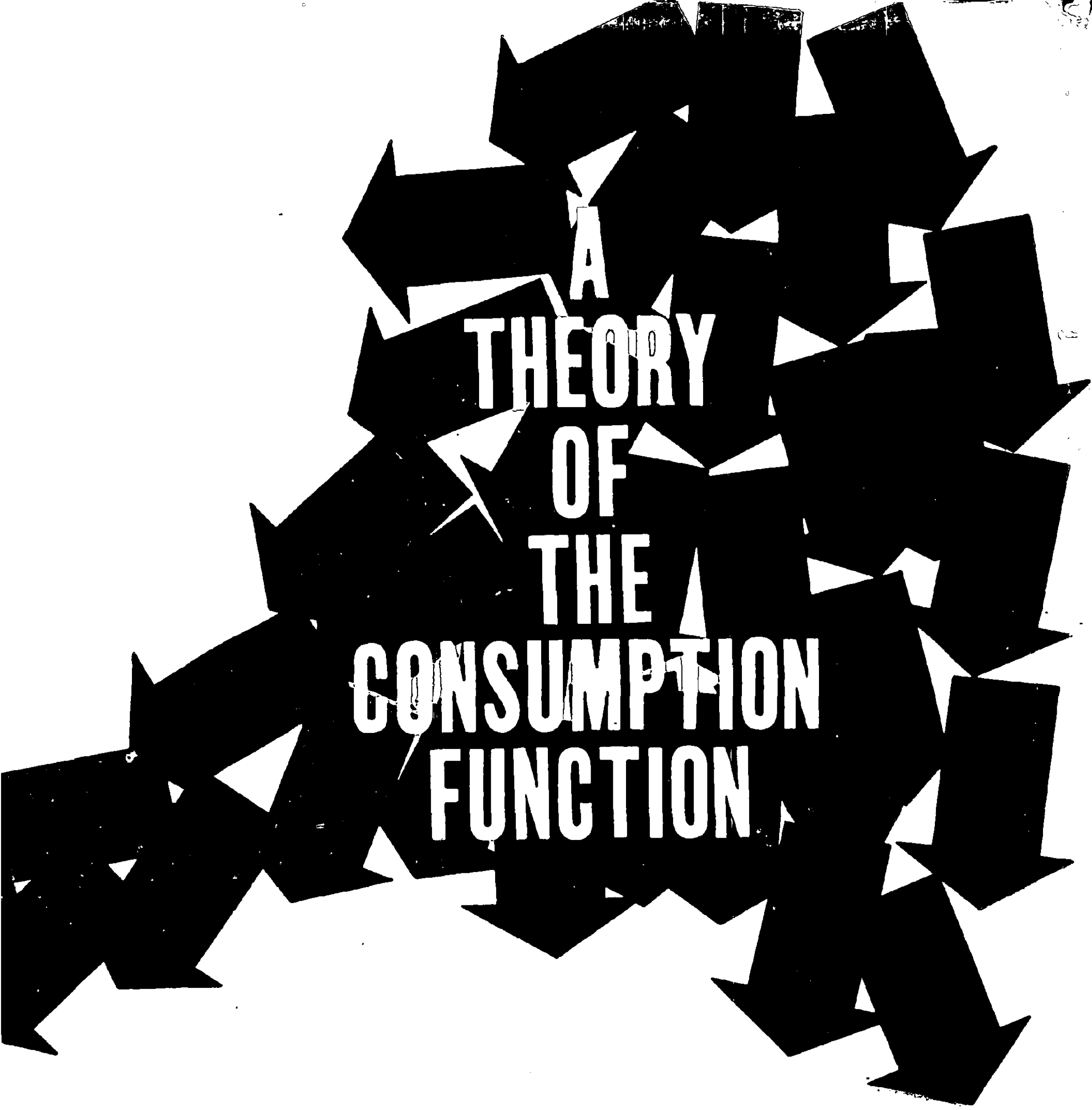

# A THEORY OF THE CONSUMPTION FUNCTION

MILTON FRIEDMAN

## A THEORY OF THE CONSUMPTION FUNCTION

What is the exact nature of the consumption function? Can this term be defined so that it will be consistent with empirical evidence and a valid instrument in the hands of future economic researchers and policy makers? In this volume a distinguished American economist presents a new theory of the consumption function, tests it against extensive statistical material and suggests some of its significant implications.

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The hypothesis is shown to be consistent with budget studies and time series data, and some of its far-reaching implications are explored in the final chapter.

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# A Theory of the Consumption Function

MILTON FRIEDMAN
*University of Chicago*

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*(Resolution adopted October 25, 1926 and revised February 6, 1933 and February 24, 1941)*

*To Janet and David*

# Preface

THE theory of the consumption function proposed in this book evolved over a number of years. During most of this period, I was not engaged in empirical work on consumption. Indeed, prior to writing this book, I had done none since 1935–37, when I was connected with the planning of the Study of Consumer Purchases. I nonetheless kept in close touch with empirical research on consumption, thanks to the combined accident of my wife's occasional interest in the field and of our joint friendship with Dorothy Brady. Mrs. Brady's unrivaled knowledge of the empirical evidence from family budget data, penetrating insights into their explanation, and deep understanding of the scientific problems involved in their analysis occasioned a series of conversations on the interpretation of consumption data, in which discussions Margaret Reid subsequently joined. Miss Reid, with characteristic enthusiasm, persistence, and ingenuity proceeded to put to a critical test the hypothesis that had been evolving out of these conversations[1] (see Chapter VII). When it seemed to be passing the test with flying colors, she pressed me to write up the underlying theory so that she could refer to it in a paper presenting her conclusions. This book is the result, and though my hand held the pen, and though I am fully responsible for all its defects, it is in essential respects a joint product of the group, each member of which not only participated in its development but read and criticized the manuscript in its various stages.

The origin of the book may explain some features of it, in particular the extensive reliance on secondary sources for data and the almost complete absence of statistical tests of significance. An hypothesis like the one presented below is typically a by-product of original empirical work; so it is in this case, but the original work was Mrs. Brady's and Miss Reid's, not my own. What systematic empirical work I did came after the development of the hypothesis, not before, and was directed at bringing together as wide a variety of data as I could with which to confront the hypothesis. It is a defect of this confrontation that I make so little use of objective statistical tests of significance. There are several reasons for this defect. First, many of the data do not lend themselves readily to such tests. For example, it would be necessary in some cases to go back to individual

[1] The earliest written version of the hypothesis I can find in my files is in a four page typescript dated June 8, 1951.

observations rather than to be content, as I have been, with means of groups. Secondly, sampling fluctuations seem to me a minor source of error, particularly in interpreting family budget data for rather large samples, compared to both biases in the samples and inadequacies for my particular purpose in the definitions used and the kind of information collected. In consequence, I have preferred to place major emphasis on the consistency of results from different studies and to cover lightly a wide range of evidence rather than to examine intensively a few limited studies.

I am indebted to Phillip Cagan for overseeing the computation of the aggregate consumption functions described in section 3b of Chapter V, as well as for much help in deciding what to compute, and to Gary Becker for overseeing some of the computations in Chapter IV, as well as for helpful comments and suggestions on the whole manuscript. Raymond Goldsmith was generous in making available to me much material from his pathbreaking study of savings before it was in print as well as in commenting on an earlier manuscript. James Tobin read an early draft of section 4 of Chapter VI, corrected a number of errors I had made in it, provided some additional computations now contained in that section, and made helpful suggestions on other parts of the manuscript; I appreciate very much both his assistance and the scientific and objective spirit that animated it. James Morgan kindly made available some of the data used in Chapter IV, and contributed some valuable comments on them; Julius Margolis and Lawrence Klein were also helpful in this connection. I am indebted to the Division of Research and Statistics, Board of Governors of the Federal Reserve System, in particular to Homer Jones, Irving Schweiger, and John Frechtling for making available to me data from the Surveys of Consumer Finances and helping me to interpret them. In addition, Frechtling read the entire manuscript and made many helpful criticisms.

A number of other friends have also read one or another version of the manuscript and have been generous with helpful comments. The late Richard Brumberg read an early version of the manuscript in its entirety and made numerous valuable suggestions for its improvement and expansion. Others to whom I am indebted for a similar service are Morris Copeland, Solomon Fabricant, Malcolm Fisher, Irwin Friend, Ruth Mack, Geoffrey Moore, S. J. Prais, George Stigler, and Frederick Waugh.

The reader shares my debt to the editors of the National Bureau of Economic Research and the Princeton University Press for their editorial assistance and to H. Irving Forman for the preparation of the charts.

MILTON FRIEDMAN

*February 23, 1956*

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