Modigliani, Franco (1918 – 2003)

Summary Article: Modigliani, Franco
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Italian-born US economist, noted for his ‘lifecycle hypothesis’ and Modigliani–Miller theorem, established with US economist Merton Miller. He was awarded the Nobel Prize for Economics in 1985 for his analysis of household savings and financial markets.

According to English economist John Maynard Keynes, the average propensity to save – the ratio of savings to income – increases as household income increases, and yet historical evidence shows no tendency for the saving rate to rise as all households become richer. US economist Milton Friedman's 'permanent income hypothesis' – which states that saving is a function, not of current income, but of expected lifetime income – provides one way of reconciling cross-sectional data with time-series data on savings. Modigliani's 'lifecycle hypothesis' – which states that individuals save during their earning years and 'dissave' after retirement – provides another: although all household income is consumed over the life cycle, a growing economy produces a positive amount of total saving because youthful savers are richer and more numerous than retired dissavers. Given some assumptions about population growth and life expectancies, this argument yields a constant historical ratio between saving and income.

In the late 1950s and early 1960s Modigliani established with Miller the basic Modigliani-Miller theorem of the Modern Theory of Finance: under perfect competition and abstracting from tax effects, both the market value of a firm and the cost of capital to the firm are independent of its debt-equity ratio as well as its dividend-payout ratio. The Modigliani-Miller theorems provoked endless controversy, thus creating what is now an entire sub-speciality in economics, financial analysis. In addition, Modigliani has been a tireless critic of monetarism, insisting on the continued relevance of the Keynesian message of demand management.

Modigliani was born in Rome, Italy. He received his first degree from the University of Rome in 1939, but emigrated to the USA at the outbreak of World War II. In 1944 he received his doctorate from the New School of Social Research in New York City. He started teaching statistics at Barnard College, Columbia University, in 1942 and mathematical economics at the New School in 1943. In 1949, he joined the staff at the University of Illinois as professor of economics, leaving in 1952 to become professor of industrial administration at the Carnegie Institute of Technology. In 1962 he moved to Northwestern University, moving again in 1962 to the Massachusetts Institute of Technology (MIT) to become professor of economics and finance. He remained at MIT until his retirement in 1988.

He was consultant to the secretary to the treasury of the USA and to the board of governors of the Federal Reserve System, and was a senior adviser to the Brookings Panel on Economic Activity. He was president of the Econometric Society in 1962, the American Economic Association in 1976, the American Finance Association in 1981, and vice-president of the International Economic Association 1976–81.

His works include The Debate Over Stabilization Policy (1986) and The Collected Papers of Franco Modigliani (1980).

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