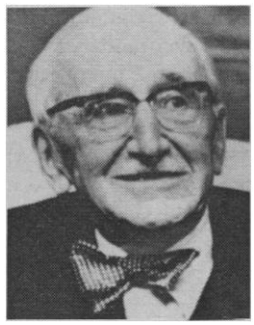
The 1974 Nobel Prize for Economics

A memoir describing the interrelationships of the works of Friedrich A. von Hayek and Gunnar Myrdal, 1974 Nobel Laureates, and John Maynard Keynes.

Economics has had, like other disciplines, its great spasms of originative glory. One such began in the later 1920's, and may be said to have ended with the second world war. The Nobel Prize for Economics was instituted in time to honor some of those who were the soul of that movement, in their years of nominal retirement. But they have not retired. Those of them who are still with us constantly astonish us by a tide of work as full and glittering as ever. In lending themselves to this, the moral sciences differ perhaps from the natural sciences, where great discoveries come early in life. It may be that the methods apt to the study of *things* are not those proper to the study of *thoughts* and the action which flows from thought. "The heart of man is unsearchable." At any rate, in the nature and affairs of men there is an ineffable subtlety, complexity, and elusiveness not reducible in its essence to a sharply delimited structure of exact formulas. I believe this has been the view of two among the great moral philosophers of this century, Maynard Keynes and F. A. von Hayek, who nonetheless appeared, in 1932, to be wholly at odds regarding the proper monetary policy to rescue the world from an unbelievable depth of business depression which, for example, was in process of halving the national income of the United States in money terms and reducing it, even in real terms, by one third. Keynes asked on one occasion how the formal precision of algebra could carry along in its argument the numberless and unseizable connections among an array of economic variables, connections "which the algebra assumes to vanish." Professor Hayek in a celebrated article has insisted on the essential importance of considering what men can know when they decide on their actions.

When the great depression of the early 1930's fell on the world like a thunderbolt, the ideas and theses which were going to be used in explaining its origin and nature were already far advanced in conception. Three men, offering prescriptions of the most contradictory diversity, all drew their inspiration from one writer, the great Swedish economist Knut Wicksell. It was he who had called attention to the consequences of a divergence, which there was nothing to prevent, between the annual cost at which a given sum of money could be borrowed from the banking system, and the annual gain to be derived from the use of that sum in buying and hiring the means of production. So long as the *money rate of interest* lay below the *natural rate of interest*, it would pay businessmen to borrow in order to extend their scale of operations. Their rivalry in bidding for extra means of production would drive up the prices of these, increase the incomes of the suppliers of such means, and enable these suppliers to compete more strongly in the markets for the products which these means produced. The prices of the products would thus be raised, and the profitability of producing them once again enhanced. So the process of a general rise of prices would continue on its self-regenerative course as long as the money rate of interest was held by the banking system at a level below that of the natural rate. The process of *inflation* was a monetary phenomenon. From these premises Gunnar Myrdal, Maynard Keynes, and F. A. von Hayek drew quite different conclusions, yet their ideas interlocked in a fascinating pattern.



Friedrich A. von Hayek

Gunnar Myrdal

In his *Treatise on Money* of 1930, Keynes introduced his Fundamental Equations, which showed how the price level of consumption goods at any time would depend on the excess, or its opposite, at that time, of the businessmen's monthly or yearly outlay on new production of equipment over the monthly or yearly saving which people as a body (wage earners and businessmen together) made out of their incomes. Can these two quantities, investment and saving, each expressed as an annual or monthly amount, differ from each other? In a coherent system of bookkeeping *records*, they cannot. For income is the value of production of goods of all sorts, both for consumption and for augmentation of industrial facilities. Saving is what is not spent out of income on consumption, and investment is what is not sold to consumers out of production. Investment and saving, it would seem, are equal *by definition*. Yet Keynes's construction of his Fundamental Equations was not fallacious. Their meaning required, for its full understanding and intelligible expression, the language already invented, some three years before the publication of the *Treatise*, by Gunnar Myrdal in an essay in Swedish. Income, in Keynes's equations, was what Myrdal defined as a quantity seen *ex ante facto*. The income of the Fundamental Equations is *expected* income, looked forward to both by those who contract to work for pay and those who hope to gain from bearing the risk inherent in giving such employment. This income can be securely counted on (broadly speaking) by those who are given employment, but there is nothing which guarantees to businessmen the realization of their hoped-for revenue. It may prove to be a loss. It *will* prove to be a loss, if saving proves, in the event, to be greater than investment. In the event? Quantities which emerge *in the event*, which appear in the bookkeeping record of what is past, are quantities seen *ex post facto*. Myrdal's contribution to the intelligibility of economic theory, a contribution inestimable in its effect and value, astounding in its simplicity, commanding in its unmistakable necessity, was the insistence on distinguishing from each other, as being wholly different in essential nature, quantities *expected* from a temporal viewpoint at the threshold of some calendar interval, and quantities, bearing the same name, *recorded* at the end of that same interval as fact. Myrdal brought into the discourse of economics the expressions *ex ante* and *ex post*, and the vital idea which they denote. Some notion of the surgical therapy thus performed for economics will be gained by considering that when Keynes, in his *General Theory of Em-*

ployment, Interest and Money of 1936, abandoned his Fundamental Equations, he was reduced to using definitional equality (that is, identity) as though it were a condition to be fulfilled. That, indeed, was a fallacy, and one from which Myrdal's idea could have saved him, had Myrdal happened to write in English instead of Swedish (1927) or German (1933), and if Keynes had not had to wait for Myrdal's English version, *Monetary Equilibrium*, until 1939. *Monetary Equilibrium*, and the German and Swedish versions which preceded it, were described by Myrdal as an "immanent criticism" of the work of Wicksell, a criticism remaining within the Wicksellian frame of ideas. But Keynes, too, in the *Treatise*, acknowledged his debt to Wicksell.

In 1931 there appeared one of the great enigmas of economic writing, one which for some years absorbed the attention of many British economists and students, especially at the London School of Economics to which Professor Hayek had recently been appointed. Hayek's *Prices and Production* drew on Wicksell, showed how too low a money rate of interest would induce an attempt to create too rapidly an elaborately specialized system of industrial equipment, the process of constructing which would starve the consumer goods industries of labor and thus lead to a powerful reaction as the resulting shortage of consumer goods made these latter industries more profitable. In this reaction the newly built equipment would in turn be starved of collaborating resources, would cease to operate, and would bring on a slump.

The argument was couched in terms of the Böhm-Bawerkian or "Austrian" theory of capital, and used that conception with an extreme condensation of subtlety and ingenuity whose difficulties explain much of the attraction as well as the ultimate unsuccess of the thesis.

The weight he thus placed on the Austrian theory led Professor Hayek to embark on a major attempt at its reconstruction. Böhm-Bawerk's theory of capital has as its purpose the extension of value theory into a time dimension. The Walrasian conception of General Equilibrium, if it is to be coherent, is confined either to a timeless or a stationary world. A stationary world is one where the state of affairs at each succeeding moment reproduces that of the preceding moment, without necessarily excluding a progression of individual items from one stage to another in a productive process. What, then, governs the total quantity or value of such items contained in the system? What is the potential effect of an increase in this quantity, and how can the notion of such an increase be brought within the conceptual framework of a stationary state? And, as a logically prior matter, how can the aggregate quantity of such items be rendered amenable to scalar measurement? Böhm-Bawerk's conception solves the problem of scalarization of an aggregate of diverse items by an arresting idea, namely, that *capital is time*. The time in question is the average lapse which occurs between the input of a quantum of the services of labor or of Nature, and the emergence of the ultimate product ready to be consumed. This *average period of production* can be shorter or longer. The difference of length corresponds to an increase in the total quantity of "original means of production" (labor and natural forces) which have been put into the productive system but not yet got out again as consumables. Such an increase has two effects. It makes possible a more subtle and powerful specialization of work, with a resulting permanent increase in the quantity of product per unit of labor or of natural forces; and it distastefully delays the enjoyment of the fruit of such inputs. Thus it has an advantage and a countervailing disadvantage, and these, in a manner wholly congenial to the methods of value theory, can be conceived to *balance at the margin*. The acceptance of the sacrifice involved in waiting longer for the fruit of identifiable quanta of input is rewarded by a permanently larger output, each successive step in whose augmentation can be ascribed to the act of renunciation involved in postponing, at some moment, the enjoyment of the fruits. Beyond some point, the sacrifice will not seem worthwhile.

Problems with Theories of Capital

This bald epitome leaves unmentioned the profound conceptual difficulties and entanglements which appear when a rigorous statement is attempted. From what *point* of time, for example, is this whole process of time-consuming production to be viewed? So long as we consider only a stationary state, any point in the process will do. But how can we discuss a spell of sacrificed consumption and the resulting lengthening of the period of production, within the framework of stationariness? If there is change, one temporal viewpoint will give us a different picture from that offered by another. A *structure* of capital involves a forward or a backward view, with all that this entails. For what exists, exists at a moment, not spread along a segment of the calendar. Yet there were great incentives to achieve a theory of capital.

Such a theory provided one account of the source and determination of an interest rate, and thus offered Wicksell an interpretation of the "natural rate of interest." For Hayek, it was the rate to which the bankers who created money by lending it must conform if the money was to be "neutral" in its effect on the general price level, leaving it as it would be in a system using money as a mere numéraire for generalized barter.

It is sometimes supposed that debates such as that of 1932 between Keynes and Professor Hayek, or in our day between "monetarists" and others, indicate a basic opposition of views about the nature of economic society. Physicians can disagree about the nature and best treatment of diseases. They do not disagree about the character of metabolic functions and of human physiology as a whole.

The roots of the fame which has led this year to their Nobel Laureateships lie in the part which Professor Gunnar Myrdal and Professor F. A. von Hayek had in giving clarity and extended meaning to the suggestions of Wicksell in the field of monetary economics. Both of them turned away to fields whose emotive appeal has given them their public reputations. Professor Hayek has seen the untrammeled working of the market economy as a necessary condition of political freedom. Professor Myrdal has devoted himself to studying anthropological and sociological causes of exclusion from economic privilege. These two careers seem to illustrate a truth: political economy leads audacious minds inevitably on to study the Human Affair in all its width and depth.

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