WILEY

The Scandinavian Journal of Economics

Gunnar Myrdal's Contribution to Economic Theory

Author(s): Erik Lundberg

Source: *The Swedish Journal of Economics*, Dec., 1974, Vol. 76, No. 4 (Dec., 1974), pp. 472-478

Published by: Wiley on behalf of The Scandinavian Journal of Economics

Stable URL: https://www.jstor.org/stable/3439253

JSTOR is a not-for-profit service that helps scholars, researchers, and students discover, use, and build upon a wide range of content in a trusted digital archive. We use information technology and tools to increase productivity and facilitate new forms of scholarship. For more information about JSTOR, please contact support@jstor.org.

Your use of the JSTOR archive indicates your acceptance of the Terms & Conditions of Use, available at https://about.jstor.org/terms

Wiley and *The Scandinavian Journal of Economics* are collaborating with JSTOR to digitize, preserve and extend access to *The Swedish Journal of Economics*

JSTOR

This content downloaded from
149.10.125.20 on Mon, 17 Jan 2022 18:53:42 UTC
All use subject to https://about.jstor.org/terms

GUNNAR MYRDAL'S CONTRIBUTION TO ECONOMIC THEORY

A Short Survey

Erik Lundberg

Stockholm School of Economics, Stockholm, Sweden

During a short period of his life—say from 1925 to 1933—Myrdal was a pure economic theorist. He began this part of his scientific career with his doctor's thesis in 1927, *Prisbildningsproblemet och föränderligheten* (The Problem of Price Formation under Economic Change). He made a study of how prices are formed, profits occur and capital value changes come about as consequences of *anticipations* of future changes in market conditions and technical development. His analysis, carried out on a micro basis, focused on the planning of the individual business enterprise. The main questions referred to how conceptions of risks and valuations of risks affected expected and realized profits as well as production and investment plans. In this study, which has been published only in Swedish, Myrdal followed up problems treated by Fisher, Knight and Hardy and anticipated a good deal of later research in risk, information and search theory. Ingvar Svennilson was the only real follower of Myrdal's ideas on the micro level. But Svennilson's dissertation of 1938, *Ekonomisk planering* (Economic Planning), was never translated either.

It is of interest to note that Myrdal transferred a great deal of the ideas and concepts in his doctor's thesis to his works in macroeconomic theory published in the 1930's: "Om penningteoretisk jämvikt" (*Ekonomisk tidskrift*, 1931). An enlarged version of this paper came out in book form in 1933: *Der Gleichgewichtsbegriff als Instrument für Geldtheoretische Analyse* and finally appeared in 1938 in an English translation (with some additions and changes) entitled *Monetary Equilibrium*. The German book had an important impact on the debates on monetary analysis. Myrdal became one of the founders of the "Stockholm School", where his concepts of *ex ante* and *ex post* became incorporated very quickly into the terminology of dynamic analysis.

During the crisis in the beginning of the 1930's, Myrdal became deeply engaged in questions of *economic policy*. He wrote a short survey of Sweden's monetary and exchange problems in 1931. But his main interest was in fiscal policy and he became—as an advisor to the new socialist government (from 1932)—strongly involved in showing the possibilities of an expansive fiscal

This content downloaded from 149.10.125.20 on Mon, 17 Jan 2022 18:53:42 UTC
All use subject to https://about.jstor.org/terms

policy. Actually he was one of the pioneers in this field, being one of the first to present a systematic theoretical framework for fiscal policy recommendations in: "Finanspolitikens ekonomiska verkningar" (1934) (Economic Effects of Fiscal Policy).

During his period as an economist of "pure theory", Myrdal signaled his dissatisfaction with the results of isolated theoretical reasoning and indicated that in the future economics should move in the direction of "*institutionalism*". This attitude comes out quite clearly in 1930 in his book *Vetenskap och politik i nationalekonomin* which was published in German in 1932 and in English in 1953 under the title: *The Political Element in the Development of Economic Theory*. This is in fact a study of the history of economic doctrines—and is still used as such in teaching—but the analysis of a number of economic theories (such as the classical and neoclassical theories of value, the doctrines of free trade, of the public sector and of social values in the economy as a whole) has the very specific aim of revealing the *normative elements* that have made it possible to draw political conclusions from theoretical models. One of Myrdal's important conclusions is that there is a need for a clear, explicit presentation of the value premises and a critical account of the institutional conditions behind the theory.

The following short account of Myrdal's achievements in economic theory is only intended to give a bird's eye view of his main ideas without going into analytic details. In my opinion, it is Myrdal's ideas and conceptions of the lines along which dynamic analysis should develop that is interesting, and not how he actually constructed his models. In fact, we find that a good deal of the ideas presented in Myrdal's theoretical works during these early years return in his later works and are applied as theoretical cornerstones in his broad studies of the negro problems in the U.S. and the poverty problems in developing countries (see Reynold's survey, pp. 479–497). The best example is perhaps the recurring application of the concept of the cumulative process with an indifferent equilibrium position to the "vicious" circles of unemployment and poverty.

The main problem in Myrdal's dissertation is how future economic changes, as *anticipated* by economic subjects, affect price formation processes in the current period because of changes in the behavior of entrepreneurs, credit institutions, etc. There are, according to Myrdal, no "normal" or "virtual" static equilibrium positions that govern actual price developments. Price trends cannot be discerned on the basis of some kind of static *ceteris paribus* conceptions. Expectations of future changes have an independent impact backwards in time which cannot be neglected. These expectations take the form of probability judgements as to various anticipated outcomes of receipts and costs. Myrdal explicitly makes the distinction—with many references to Frank Knight's well-known book *Risk, Uncertainty and Profits* (1924)—between a change that is completely foreseen a reasonable time in advance and one that

This content downloaded from
149.10.125.20 on Mon, 17 Jan 2022 18:53:42 UTC
All use subject to https://about.jstor.org/terms

is unforeseen—a complete surprise. When technological change or a change in demand is anticipated with full certainty and discounted, then this change cannot cause profits and losses when it actually occurs. The opposite is a completely unforeseen change causing unexpected price and cost changes and therefore capital value changes, profits or losses to the individual entrepreneur. In reality there is a mixture of these two cases and Myrdal introduces the device of letting expectations be combined with risks (and chance).

The essence of Myrdal's theoretical structure of dynamics can be summarized under four assumptions:

1) The *time element* contains uncertainty as well as the inertia of capital and production structure.
2) For each entrepreneur there is some kind of *objective risk* as to his expectations of future outcomes, depending on his experience and ability.
3) There are *personal risks* with regard to the enterprise (or the entrepreneur) from the credit suppliers' side. A large share of paid-up capital will reduce this risk.
4) Myrdal regards the *non-neutral evaluation of risks* as a central problem. Undervaluation and overvaluation (optimism and pessimism) and the dispersion of risks and evaluations among investing enterprises will have important effects on the price of risk-bearing.

There are certainly many difficult problems involved in this distinction between objective and subjective risks and the valuation process of expectations. Myrdal frequently refers to the writings of Marshall, Fisher, Keynes and Knight and he is quite aware of the difficulties involved. Myrdal's discussions contain some forebodings found in modern literature on information and search processes. He has vague suggestions as to how his hypotheses can be tested by comparing ex ante profitability calculations with actual outcomes. His main efforts, however, remain within the realm of pure theory on a very abstract level.

It is not easy to discern exactly what Myrdal meant by the term objective risk. It sometimes has a connotation of a mathematical probability such that if the same investment were repeated a large number of times under the same circumstances the total outcome would agree with the anticipations. But at the same time Myrdal stresses the subjective nature of the entrepreneurial risk concept. The entrepreneur's judgement of price and production risk must be vague and approximate and a function of his own degree of ignorance, experience, information and skill. The conception of risks will also change over time as a result of a learning process. The important point, according to Myrdal, is to distinguish a neutral risk concept as an *objective norm* from the *valuation of the risk*—with an optimistic or pessimistic bias including risk aversion matters.

This content downloaded from
149.10.125.20 on Mon, 17 Jan 2022 18:53:42 UTC
All use subject to https://about.jstor.org/terms

Myrdal gives an interesting account of a tendency towards concentration of activity to entrepreneurs with the lowest objective risks (because of skill, information, etc.) who invest in their most optimistic moods during boom times when there are optimistic forecasts. He studies possible effects on investment calculations, choice of techniques, substitution effects, choice of plant and firm size (to even out risks). In the dynamics of price formation he regards not only effects of anticipations of future changes. Myrdal also pays attention to existing disequilibria in price relations giving rise to an immediate increase in capital values and profits on new investments.

In his works on *monetary equilibrium* Myrdal shifts to macroeconomics. The setting of the problems, however, has a great deal in common with the "dynamic theory" of his thesis. We find above all the recurring comparisons of expected outcome and *ex post* results. His ambition is to work out a macro dynamic analysis in terms of anticipation variables. As in his thesis, Myrdal stresses that "dynamic analysis" must develop along two different lines: 1) a dynamic time point analysis when anticipated changes work *backwards in time* and 2) from this position *forward in time* as a causal recursive (sequence) analysis. However, Myrdal deals only with the first problem; other members of the Stockholm School took up sequence analysis forward in time.

The main theoretical concept used for analysis of dynamic change is the notion of monetary equilibrium. According to Myrdal, this can be characterized negatively as the absence of a Wicksellian cumulative process. A starting point is Wicksell's alternative definitions of monetary equilibrium: 1) the rate of interest is equal to the (expected) return on real capital, 2) the equality of *ex ante* investments and savings and 3) the constancy of the price level.

Myrdal's main criterion in the English edition is the equality of *ex ante* savings and investments during a unit period but determined at a point in time. It should be noted that Myrdal defines *ex ante* savings as a difference between the expected income during the period and planned consumption. But earlier—in the Swedish paper—the first criterion using the concept of expected returns was given priority and he tried to combine it with the conditions on the capital market.[1]

Myrdal applies his concepts of anticipations and risk to give new, more concise content to Wicksell's real interest rate. The distinction between expected and realized return on capital is clearly marked out and Myrdal presents intricate discussions of how varying anticipations of return (including risk conceptions) influence capital values of investment (by means of given nominal discount rates) in relation to capital costs and ultimately, investment plans and investment decisions are determined by this difference and some kind of reaction coefficient.

---

[1] In a survey article (in Swedish) "On Concepts and Methods of the Stockholm School" (*Ekonomisk Tidskrift,* 1941) Tord Palander presented a thorough analysis of Wicksell's and Myrdal's concepts.

This content downloaded from
149.10.125.20 on Mon, 17 Jan 2022 18:53:42 UTC
All use subject to https://about.jstor.org/terms

It is of interest to note that Myrdal continued to focus his interest—as did Wicksell—on price changes. Expectations of income and investment plans can be changed mainly because of changes in price anticipations. The Keynesian issue of demand for labor and total employment is never treated explicitly in these works. From his disequilibrium analysis—the gap between *ex ante* savings and investments—Myrdal draws conclusions as to the immediate tendencies towards a cumulative price process.

Myrdal discusses how the result of a monetary disequilibrium—measured as the difference between investment and saving plans—will result in an *ex post* equality due to gains and losses arising out of price changes (as Keynes did in the *Treatise on Money*). In another respect Myrdal comes close to modern versions of an equilibrium inflation path. He criticizes Wicksell's criterion that monetary equilibrium (in Myrdal's version) will also imply a constant price level. Any continuous (anticipated) change in the price level can conform to monetary equilibrium. To quote Myrdal: "The fundamental equilibrium conditions refer to or depend on certain relations of prices for real capital and the means of production of real capital, for finished products etc. and also the price of credit. If the equilibrium price relations are fulfilled, any movements of the absolute prices ... will leave monetary equilibrium undisturbed" (*Monetary Equilibrium*, p. 132). But, adds Myrdal—and this is a rather realistic part of the theory—some prices are quite flexible (reacting quickly to disequilibrium gaps), other prices less flexible and some very sticky. And these sticky prices act as a restraint on the whole price system so that the inertia of some prices "sets a limit to the movement of the price level permitted under monetary equilibrium" (p. 136). In the survey referred to above Palander pointed out many unclear points in Myrdal's treatment of how the development of prices may be influenced by monetary disequilibrium, especially with respect to the effects of anticipations. However, disregarding a number of unclear points, there is no doubt that Myrdal's works on monetary equilibrium contain a wealth of ideas that were new at that time.

Policy problems are not covered to any great extent in Myrdal's works in "monetary theory"; questions of monetary policy are omitted almost entirely. But in the theory of *fiscal policy* Myrdal was clearly one of the pioneers in working out a theoretical framework of economic policy. His first contribution—presented in 1932—came as an appendix to the budget proposition of the Swedish Minister of Finance. His more systematic study of the possible effects of various fiscal policy measures appeared in 1934.

These are works on policy principles based on rather loose theoretical propositions without statistical applications, but incorporating some of the institutional framework. There is thus no stringent type of consistent theory or policy model in the book but many ideas as to how various fiscal measures may counteract depression forces. Thus, the whole idea of the multiplicative effects of public works in a cumulative process are there, based on the notion

This content downloaded from
149.10.125.20 on Mon, 17 Jan 2022 18:53:42 UTC
All use subject to https://about.jstor.org/terms

of savings and consumption propensities, taking into account the effects of import leakage and the transmission of demand over stages of production, observing the importance of time lags, especially as to retardations arising from inventory disinvestment. Eventual effects on prices and fixed investments (depending on capacity utilization) are observed.

Myrdal is very effective in fighting off the fears (of his older colleagues as well as of politicians and businessmen) that the financing of rising budget deficits due to expensive policy will imply reduced supply of savings and credits to the private sector of production. He applies his own version of how an increase in investments over *ex ante* savings will *ex post* automatically create the deficient *ex post* savings by means of increased profits and other incomes. The condition is—as Myrdal emphasizes—a flexible monetary policy; he pays attention to the need for an integrated fiscal and monetary policy.

One of his main contributions refers to his extensive discussion of the so-called *international space* for an autonomous expansive policy in a country like Sweden. He deals with a number of cases with fixed and flexible exchange rates, with and without sufficient exchange reserves, with supporting or adverse capital movements and pays particular attention to the strategic problems of confidence. One important part of the policy issue in Myrdal's treatment is to find ways of widening the international space for an expansive policy. He discusses measures such as devaluation, borrowing from abroad, higher import duties or import regulations. Much emphasis is given to possibilities of directing expanded public expenditure to areas with low import propensities and of tax reductions that directly and indirectly stimulate exports or import-substituting production. In sum, this book contains most of the arguments for expansive fiscal policy that are used today—and that was indeed an achievement 40 years ago.

As mentioned in the introduction Myrdal had, already at an early stage, a critical attitude towards the normative content of a good deal of economic theory. His work from 1930 on *the political or valuation element* in much of economic theorizing from the beginning (Hume and Adam Smith) up to the liberal gospels of his teachers and colleagues of the 1920's (Wicksell, Cassel, Heckscher, Lindahl) led him to the conclusion that all value premises should be explicitly presented and not concealed in vague and methaphysical concepts or illogical reasoning. Myrdal's book contained a broad survey of economic doctrines which led to policy conclusions with regard to the great economic issues of the times. His main theme was that it was impossible to reach political conclusions solely on the basis of pure, theoretical analysis. The immanent criticism of the theories should reveal how the normative elements had entered.

Myrdal believed in 1930 that such a cleansing process would leave a positive theoretical structure and that the value premises could then be presented separately. In particular, he was after the basic assumptions of essential harmony as between individuals and groups in a national economy, e.g. in

This content downloaded from
149.10.125.20 on Mon, 17 Jan 2022 18:53:42 UTC
All use subject to https://about.jstor.org/terms

economizing with scarce resources, abstracting from all actual and potential conflicts of interest (as income distribution). This neglect can possibly be tolerated—but should be analyzed separately—in a large crisis or in a deep depression, as the case is actually presented in his book on fiscal policy. Only under these conditions can economics claim to be objective.

A further conclusion is that from these points of view, economists should also scrutinize the *institutional conditions* of an economic system. As is well known, Myrdal—at least since *An American Dilemma*—regards himself as mainly an "institutional economist"—and is proud of it!

It should be added that Myrdal later came to regard his treatment of the valuation premises in his book from 1930 as very "naive empiricism". According to post-war Myrdal, the normative elements cannot be isolated in the straightforward way he imagined in 1929. This view is presented clearly in the preface to the English edition of the book. In any number of forewords to his books, pamphlets and papers Myrdal has returned to valuation problems in economics, and sadly enough the clear-cut and extremely stimulating exposition and refreshing conclusions of 1930 have disappeared and have been substituted by rather muddled thoughts on value relativity problems entering at every stage of research, from the observation of facts to the conclusions. Anyhow—as Myrdal himself asserts, in spite of his later attitudes—his book of 1930 preserves its high value as a critical account of central economic doctrines.

This content downloaded from
149.10.125.20 on Mon, 17 Jan 2022 18:53:42 UTC
All use subject to https://about.jstor.org/terms