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## **Finn E. Kydland [Ideological Profiles of the Economics Laureates]**

Daniel B. Klein, Ryan Daza, and Hannah Mead

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### **Abstract**

Finn E. Kydland is among the 71 individuals who were awarded the Sveriges Riksbank Prize in Economic Sciences in Memory of Alfred Nobel between 1969 and 2012. This ideological profile is part of the project called “The Ideological Migration of the Economics Laureates,” which fills [the September 2013 issue of \*Econ Journal Watch\*](#).

### **Keywords**

Classical liberalism, economists, Nobel Prize in economics, ideology, ideological migration, intellectual biography.

### **JEL classification**

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[http://econjwatch.org/file\\_download/739/KydlandIPEL.pdf](http://econjwatch.org/file_download/739/KydlandIPEL.pdf)

# Finn E. Kydland

by Daniel B. Klein, Ryan Daza, and Hannah Mead

Finn Kydland (1943–) grew up in a small farming community in Norway. He was the only one in his elementary school class to go on to high school. In high school, Kydland concentrated on math and physics; he has said “I knew more math at the end of high school than a typical American business or economics major” (Kydland 2005a). He continued to the Norwegian School of Economics and Business Administration, in Bergen. Kydland has explained why he chose that school, rather than the University of Oslo, which had greater prominence in academic economics:

When I started studying at NHH [the school in Bergen], it was not for the sake of studying economics. An acquaintance of mine...had set up a couple of innovative businesses...and he introduced me to business. I helped him with his accounting and soon realized I would rather be a business economist...than a civil engineer..., on which I had set my sights originally. So when I arrived at NHH I had no idea what modern economics was about. I thought I was studying to get qualifications to work in business. That I did not end up in business was basically an accident. (Kydland 2006, 360)

At Bergen, with his quick ability to learn computer programming, Kydland caught the eye of his professor Sten Thore. Kydland became Thore’s research assistant, which led to him visiting Carnegie-Mellon University, where he would go on to earn his Ph.D. in economics and be highly influenced by Robert Lucas and write his dissertation under Ed Prescott (Kydland 2006, 364-366). After getting his degree, he returned to Norway to teach at his undergraduate alma mater. After over a decade there, Kydland returned to Carnegie-Mellon (Kydland 2005a).

Kydland is extremely reticent about talking politics—he refuses to bite when interviewers try to draw out his political judgments (e.g., Kydland 2006, 378)—but it seems that Kydland leans toward free-market policies. Kydland signed a petition against protectionism (Hedengren et al. 2010).

Kydland and Prescott shared the 2004 Nobel Prize in Economics “for their contributions to dynamic macroeconomics: the time consistency of economic policy and the driving forces behind business cycles.” Kydland and Prescott (1977) famously explicated the time inconsistency problem, wherein even a benevolent ruler will switch away from a policy strategy that, in one sense, had been “optimal,”

if she does not commit to it from the start: Even a benevolent ruler may wish to go back on her promises, because of conflicting interests among the populace.

Kydland spoke on policy implications in a 2008 interview:

While it's important to determine the best policies, you have to be consistent over time, and that's difficult in the face of this discovery that optimal policy is time inconsistent. When they reevaluate policies in the future, policymakers will no longer have the incentive to take into account the effect on decisions that have already been made. In the long run, the prediction is that you'll be worse off.

So how can you commit policymakers to carry out consistent policies? We limit their discretion with rules designed to encourage time consistency. It seems to work better in the context of monetary policy than fiscal policy. In monetary policy, the attempts to isolate central bank policy from political pressure by, say, making the central bank independent, have been a good thing.

In some countries, it's clear that the central bank is very much under pressure from the rest of the government. If the bank's head doesn't do what the other policymakers want him to do, he's simply replaced. There are many countries in which the tenure of the central bank head has been on the order of a year or less. In Argentina, for example, there were years in which the central bank head was replaced five times. (Kydland 2008, 9)

Carlos Zarazaga describes Kydland's discovery of time inconsistency:

[T]he outcome of the game was different, depending on whether the players were forced to make all their decisions for the entire future at the beginning of the planning period (the open-loop solution in the so-called sequence space) or allowed to choose their actions one period at a time (the feedback solution in the so-called policy space). (Zarazaga 2008)

The insight, Zarazaga says, "had far-reaching consequences for the theory of policymaking":

It implied that the reason governments around the world seemed to be unable to implement policies that were the best according to optimal control theory was not necessarily, as it was widely believed, myopic or incompetent policymakers. Rather, it was the inherently dynamic nature of the policymaking process, when there is feedback from the

future to the present and societies lack commitment mechanisms to bind the decisions of not-yet-born policymakers. (Zarazaga 2008)

One application of time inconsistency Kydland and Prescott found was that while low capital taxes maximize consumer welfare, the short-run interest of government may be to drift toward higher capital taxes, a hazardous temptation if the government has not pre-committed to keeping tax rates low (Kydland 2005a).

When asked whether his work with Prescott was influenced by the work of Milton Friedman, Kydland responds, “No, not in the slightest.” He adds: Friedman’s “starting point was completely different. His basic message was that if you did not know enough about how economies reacted, measures you put in place could have the opposite from the desired effect. And that was simply not an issue in our work” (Kydland 2006, 374).

On business cycles, Kydland and Prescott argued that productivity changes led to business cycles, a view known as real business cycle theory. Working with Prescott, Kydland found that productivity shocks accounted for between 50 and 70 percent of business cycles. The finding went against both the monetarist and Keynesian stories of the business cycle (Zarazaga 2008).

An implication is that more fluctuations in monetary policy will actually reduce business cycle volatility as people do not adjust their output in response to price shocks. Kydland (2005a) says, however, “Of course, this reduction in volatility is by no means welfare improving!”

Kydland has commented that investors do not appear to respond to long-term tax breaks, but will respond to short-term ones. Long-term policy stability, however, he says is more important (Kydland 2005b).

In 2013, Kydland and Zarazaga released a working paper that reflects Kydland’s emphasis on expectations and on government as a dominant force that is quite possibly none-too-helpful, nor wise. The paper suggests that the U.S. economy is not recovering strongly from the Great Recession of 2008–2009 in part because of “the prospects of an imminent switch to a higher taxes regime prompted by the unprecedented fiscal challenges faced by the U.S. economy in peacetime” (Kydland and Zarazaga 2013, abs.).

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## Wassily Leontief

by Daniel B. Klein and Ryan Daza

Wassily Leontief (1906–1999) grew up in St. Petersburg, Russia. His father was a professor of economics at St. Petersburg University and traveled abroad, where he met his wife in Munich, who was of a rich Jewish family from Odessa. Leontief describes his immediate family as different from his grandparents who were Old Believers (Leontief 2006/1994, 347). He described his family's political ideology in a 1990 interview:

Our family was intellectual bourgeois with liberal views. When my father was young, he organized strikes at the factory of my grandfather. That, you know, is a typical Russian behavior. Later, when he was a professor, he seriously studied Marxism and did research on the economic situation of workers in Russia. This was the topic of his doctoral dissertation.

[My mother] was a well-educated woman, a *bestuzhevka*. She studied history of art. She knew four foreign languages. She was from a quite well-to-do family, but the young people from the family engaged in revolutionary activities. When my mother was young, at the beginning of the century, she was even arrested for participation in some activity against the Tsar. She was in prison, but it was not serious