# In Memory of Alfred Nobel


## Holley Ulbrich

### Senior Scholar, Strom Thurmond Institute


*This article is the twenty-third in a year-long series about economics and holidays.*

Alfred Nobel was born on October 21, 1833, which is not a holiday that appears on most calendars. He is known for two contributions to the world: the invention of dynamite and the establishment of the Nobel prizes. Instead of celebrating his birthday, but his memory is honored in December when the Nobel laureates receive their awards and make their addresses. His will established the prizes in peace, medicine, physics, chemistry, and literature in 1895.

The Nobel prize in economics was not established by the will of Alfred Nobel. Instead, it was created in 1968 by the Swedish central bank, the Sveriges Riksbank, which created an endowment to fund the prize and the administrative expenses. Beginning in 1969, it has been awarded to 67 economists, all but one of them male, 42 of them Americans and another five with dual citizenship that includes American. It is considered a very prestigious award. Quoting one of these 67 in the news, the quote is always preceded by "Nobel prize-winning economist…"

In general, the award is given for significant original contributions to economic theory. But starting in 1974, when the prize was jointly awarded to Gunnar Myrdal and Friedrich Hayek, there have been political overtones as well. In that year the winners were at opposite ends of the philosophical spectrum in terms of the policy applications of their work. Gunnar Myrdal, who would today be classified as politically liberal or progressive, was very interested in economic development issues and the social and cultural context in which it took place. Hayek is a favorite among more conservative and even libertarian economists because of his opposition to central planning and his emphasis on a limited role for government in a market system. While many prize winners have been recognized for their contributions to traditional economic theory, other choices have been more controversial because they affirm an understanding of economics that focuses on the causes and consequences of market failure of various kinds. The prize, however, has been awarded to economists who lie at many points along the spectrum in their political understanding from libertarian (minimum government, maximum freedom) to liberal (greater equality and access to resources).

An emerging trend in economic thinking in recent decades has been a focus on institutional and behavioral economics. This trend has not gone unnoticed by the Nobel Prize committee. Institutional (or neo-institutional) economics explores the way that historical paths, cultural and political contexts, and the specific "rules of the game" in a particular economy will affect the way in which market forces work and the outcomes of particular policies. Behavioral economics explores the ways in which decisions by actual individuals differ sharply from the role of the rational, self-interested, calculating economic man of traditional theory. In general, behavioral economists conclude that humans as economic actors are motivationally more complex and cognitively less capable than economic theory assumes. That is, motives include the interest of others as well as one's own self interest, and the thinking processes behind decisions rely on habit, intuition, social norms, and the way in which the choices are framed or presented.

It is hard to divide the prize winners into traditional, neo-institutional, or behavioral in their focus because all three elements are usually present in work sufficiently significant and distinguished to earn the Nobel Prize. However, some economists have contributed more heavily to neo-institutional or behavioral understanding of economic processes than others. Among the economists who have been recognized by the Nobel Prize Committee for contributions to economics that are primarily neo-institutional and/or behavioral in nature are Herbert Simon (1978), James Buchanan (1986), Ronald Coase (1991), Gary Becker (1992), Douglass North (1993), John Nash (1994), Amartya Sen (1998), Daniel Kahneman (2002), Thomas Schelling (2005), and Elinor Ostrom and Oliver Williamson (2009). Kahneman and Ostrom are actually not economists by profession and training: Kahneman is a psychologist and Ostrom, the first woman to receive the prize, is a political scientist.

What kind of contributions did these eleven economists make? Each of them was concerned with context and/or behavior. They cannot be classified neatly into liberal or conservative, libertarian or progressive. Simon gave us the term bounded rationality, which means that we make our decisions within a limited set of options. Buchanan stressed the importance of the constitutional rules in protecting us from self-interested behavior by those who have political power. Coase is famous for showing how conflicts of property rights can be resolved privately if the number of parties is small enough and transactions costs are not too large, but that in general the assignment of property rights has a significant effect not just on the individuals but on the efficiency of the economy as a whole. Gary Becker expanded economic theory to take on such issues as motivations to marry and have children or commit crimes. North is an economic historian who gave economists a favorite phrase, "path-dependent state," which freely translates as "you are where you are because you've been where you've been, and that limits the options for where you go from here." Nash, made famous by the movie *A Beautiful Mind,* helped us to understand some of the strategic elements of economic decisions. Amartya Sen focused on issues of inequality and the context of rules and processes that led to poverty, famine, and other social ills. Kahneman helped to explain some of the cognitive issues, such as framing and attitudes toward risk, that would lead people to make choices that do not conform to the rational, self-interested model of human behavior. Schelling's work focused on the collective consequences of individual choice that may result in less satisfactory outcomes than we would have had if it were possible to coordinate our decision-making. Ostrom's contributions are in the area of management of common pool resources, which do not fit neatly into traditional models, while Oliver Williamson's work was in understanding the role of transactions costs in influencing economic decisions.

The work of all of these economists and others has resulted in a less tidy and mathematical understanding of economic process, but also a firmer foundation for making economic policy that reflects how actual people think and how the existing social rules (laws, customs, social norms) affect he outcomes of economic policy. Twenty-first century economics is much richer and more useful as a guide to policy as a result of the emergence of neo-institutional and behavioral economics, and it is appropriate for so many of the Nobel prizes in economics to have been awarded to pioneering work in these areas.