

## THE ACHIEVEMENT OF ARNOLD HARBERGER

by Julio H. Cole

Good morning.

I should start out by saying what a great honor it is to comment on Professor Harberger's paper. I'm very grateful for the opportunity, but I should also confess that when I first received the invitation I was also overcome by a sense of inadequacy. I was never a student of Harberger, nor did I ever work closely with him on any major project.

(I did participate in a minor capacity on a project for policy reform in Guatemala that he led in the early 1990's, but I was just one member of a very large team, and I did not have much direct interaction with him.)

So I can't say that I know him well. On the other hand, for a long time I have admired his style as an applied economist, and I have long been aware of his writings in several different fields of applied economics, writings that I have studied with care and often cited in my own work.<sup>1</sup> And even though I have not myself worked in most of the areas to which he has devoted most of his career — public finance, for instance, has never been a major field of mine, nor have I done much work in project evaluation<sup>2</sup> — I can say that “Alito”, as he is known throughout Latin America, has been a major role model for me, an experience that I know I share with many other Latin American economists of my generation.

Unfortunately, I received the draft of his presentation only recently, so I haven't had time enough to prepare a detailed comment on the paper he just delivered. But over the past couple of months I have been reading and re-reading quite a bit of his published work, and what I would like to do today is comment briefly in a general way on why I think Alito has been so influential among economists and policy professionals in this part of the world — an influence, I should add, that throughout his long career has had an enormously positive effect in moving the direction of economic policy towards a greater reliance on the free-market principles that the Mont Pelerin Society has always stood for. I will also offer some personal observations that come from the memories of a “lifetime Harberger observer”, that I think will illustrate some of the points I will try to make.

To place his contribution in context, one has to picture first what the dominant paradigm in development economics looked like when he first came to Latin America in the mid-

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<sup>1</sup>Two papers that I have cited many times are Harberger (1963) and Harberger (1981). I have also often cited several of the papers collected in Harberger (1984).

<sup>2</sup>On Harberger's contributions to these fields see Hines (2001) and Harberger (1987, 1994, 2003).

1950's.<sup>3</sup> In retrospect, when one reviews the development literature of that time, one thing that seems very striking is that the “experts” all seemed much more self-confident than they are today, and they would often formulate grandiose plans that called for major structural transformations, with a corresponding role for extensive government involvement in the economy.

Indeed, one common feature of the development models of the time is that they all involved extensive state action, not only in planning but often in the direct allocation of resources. The state was viewed as the major agent of change, and governments were expected to promote capital formation, provide employment for so-called “surplus” labor, and promote industrialization through “import-substitution” — often through direct investment of public funds.

Against these grandiose and extremely sanguine visions of what could be achieved by government action, Alito brought instead a much more humble and modest vision of what governments could achieve. He also observed that these countries were all rife with inefficiencies and economic distortions, most of them arising from misguided or poorly designed government policies.

Industrialization based on import-substitution, for instance, instead of leading to economic development through increased productivity, more often than not merely protected inefficient domestic producers by raising artificial barriers to foreign competition. Many of these countries also suffered from high inflation due to chronic government deficits financed by money creation, and this invariably led to major price distortions, as governments attempted to control the rise of certain sensitive prices. Major distortions were especially prevalent in interest rates and in currency exchange rates. All of these distortions led to reduced productivity and reduced living standards due to inefficiencies and misallocation of resources.

So instead of trying to jump-start development by implementing these overly ambitious development plans, why not start out by reducing the waste of resources? Alito not only understood the causes and consequences of these distortions, but he was also very effective in explaining, often in very vivid terms, the nature of these problems and the best ways to solve them. As an illustration, I'd like to share a personal anecdote, if I may. When I was still an undergraduate student, I once attended a lecture that Alito gave at Universidad Francisco Marroquín, in Guatemala. Alito was a personal friend of Muso Ayau, the founder of our university, and he has visited our campus many times over the years. This particular visit was in the mid-1970's, and it might have been his first visit to Guatemala.

Anyway, he was telling us about the inflation in Chile during the Allende years, and how it led to pervasive price controls, the ensuing shortages, and the consequent need to subsidize certain basic commodities, such as bread, and how this led to even more distortions, because at the artificially low, subsidized prices, buyers had no incentive to allocate

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<sup>3</sup>A good review of how the field of development economics has evolved over the second half of the 20<sup>th</sup> century is provided by Meier (2001).

resources to their highest valued uses. And to illustrate this he told us something that has stuck with me to this day, 40 years later: Bread was so cheap, in real terms, that for pig farmers it was cheaper to feed their hogs with bread than with corn. And this image was so shocking to me that, as I say, it has stuck with me to this day, and I can still feel the sense of outrage that I felt, that scarce foreign exchange was being wasted in order to import wheat, so that pig farmers could feed their hogs with freshly baked bread.

I should add that this particular lecture probably pushed me into studying economics as a profession. I was uncertain as to what major to choose, but after that lecture I was “hooked” forever, and I’m pretty sure that many other young students like me must have had the same experience. (And perhaps even with the same example, as he must have used it many times.)

In any case, Alito’s lecture had a galvanizing effect on me, and I’m pretty sure that his lecturing must have had a similar effect on scores, perhaps hundreds, of other students of my generation. His lectures not only imparted knowledge and information, but also a sense of mission, a sense that these things should not be allowed to happen, that something should be done about it. And this sense of mission must have been especially pronounced among his first group of students during the years he spent in Chile, and even more so in the case of the group that went on to study with him at the University of Chicago — the core of the famous “Chicago Boys”.

Indeed, when one reads the personal memoirs of some of the “Chicago Boys” — in preparing this presentation I read, for instance, the memoirs published by Ernesto Fontaine, who died last year, I’m sad to say ... it’s a fine book by the way<sup>4</sup> — one thing that you get when you read these memoirs is a strong sense that, to many of Alito’s students, the study of economics became not just a matter of learning how to use certain tools. It also became a commitment to using those tools to rid the world of many unnecessary evils and imperfections, a commitment to help make the world a better place. And I believe Alito was very effective in conveying this sense of mission, because he himself was committed to these ideals. This partly explains his success. To succeed in anything you have to believe in what you’re doing.

I say *partly*, however, because in itself this strong sense of mission would not have been enough. Many other libertarians — quite a few of them are members of this society — are just as committed, but unfortunately they have not been anywhere nearly as successful in spreading their ideas. At least not in a policy-relevant sense. I’m thinking specifically of economists who follow the Austrian School, the followers of Mises and Hayek. No one is as committed to free-market economics as these thinkers, and certainly they have made great contributions to our theoretical understanding of the market economy and how it works. And yet I’m sure that everyone here would agree that, in terms of practical impact on actual policy-reform, the influence of their teaching has been virtually nil.

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<sup>4</sup>Fontaine (2009). This book has a foreword by Arnold Harberger.

Alito himself sets great store by what he calls “relevance” in economics. He views economic theory as a tool with real policy implications, and in his work he has always stressed the importance of basing policy analysis on observations of the real world.<sup>5</sup> I’m sure he’s right about this, and in any kind of communication the *content* of what you have to say is certainly important. But the *way* you say it is important as well. I personally believe that one factor that explains Alito’s greater success in spreading his ideas, especially among professional economists, is that he (and Chicago economists in general) has always used essentially the same language as most mainstream economists, that is, the language of neo-classical economics.

And to bolster this claim I want to cite from a very old paper by Israel Kirzner — who is of course one of today’s most distinguished exponents of the Austrian School. Back in 1967, in assessing the comparative influence of Chicago School economists *vis-à-vis* their Austrian School counterparts, Kirzner noted the following:

The price theory that underlies the contributions of the “Chicago” writers is not fundamentally different from that accepted by American economists generally, including those holding the efficiency and justice of the market system in deep mistrust. It is merely that the “Chicago” economists apply their price theory more consistently and more resolutely, assigning to it a scope of relevance far wider than that granted by others . . . . “Chicago” price theory, like that taught in most United States economics departments, is solidly in the Anglo-American neoclassical tradition associated most importantly with Alfred Marshall (Kirzner, 1967, p. 102).

To use a bit of economic jargon, one might even say that Harberger, in using the language of neo-classical economics, had a “comparative advantage” in communicating with other economists, as compared to Mises and Hayek, whose Austrian School background seems much more alien to other members of the profession.

There is one other factor that I would like to mention, that I also believe is important in explaining Alito’s success in communicating with policy-makers, and I’m not sure how I should phrase this. Again, I have to confess that I don’t know him well, so I’m really sort of guessing here, but from what I can glean from his writings and his public pronouncements, the impression I have is that Alito, for a libertarian, is not a very ideological person. And there’s one particular aspect of this that I want to stress here, and it’s that, if you want to influence economic policy, you have to be able to get along with government officials and public sector economists. And you won’t be able to do that if you view them as the enemy.

So I’m pretty sure that one important factor that explains Alito’s success in public policy reform is that he gets along very well with people in the public sector. He has been a consultant to governments in many countries, and many of his former students have been high-level government officials in their own countries — most notably in Chile, of course, but in many other countries as well. Indeed, Alito often brags about the number of his

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<sup>5</sup>See, for instance, Harberger (1988) and Harberger (1993).

former students that are or have been ministers of finance, or central bank presidents.<sup>6</sup> He also has many former students in the major international institutions, such as the World Bank and the IMF, and also in the US Agency for International Development.

Let me just end by saying that throughout his long career Arnold Harberger has been a tremendous force for good, and that the world would be a much better place if there were many more economists like him.

Thank you very much.

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<sup>6</sup>See, for instance, Levy (1999) and Mansell-Carstens (2003).

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