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Sense and Economics: An Oral History with Arnold Harberger

Interviews conducted by
Paul Burnett
in 2015 and 2016

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Economist Life Stories

The impact of economics in our society is hard to overstate. Economics structures government policy, guides decision-making in firms both small and large, and indirectly shapes the larger political discourses in our society.

To enrich the understanding of the influence and sources of powerful economic ideas, the Becker Friedman Institute for Research in Economics at the University of Chicago set out in 2015 to capture oral histories of selected economists associated with Chicago economics. The aim was to preserve the experiences, views, and voices of influential economists and to document the historical origins of important economic ideas for the benefit of researchers, educators, and the broader public. This oral history with Arnold Harberger, conducted in seven day-long sessions in Los Angeles, CA from the fall of 2015 to the fall of 2016, is the second interview for the project.

Economist Life Stories is more than a collection of life histories; it chronicles the history of a scholarly community and institutions at the University of Chicago, such as the Graduate School of Business, the Cowles Commission, and the Department of Economics. It also reflects the achievements of faculty and students in the domains of economic policymaking and private enterprise around the world. Although this project focuses on the leaders and students of the University of Chicago Department of Economics, the Graduate School of Business, and the Law School, we hope to add more stories from economists around the world as the project expands.

Acknowledgments

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Arnold Harberger, photograph by Anna Harberger, 2016

Arnold Harberger is the Gustavus F. and Ann M. Swift Distinguished Service Professor Emeritus, University of Chicago and Professor of Economics Emeritus, University of California, Los Angeles. Dr. Harberger is perhaps most widely known for overseeing the Chile Project, which trained Chilean students in economics who then went on to found programs in economics and take up positions in the Chilean government. However, that story is merely one in Dr. Harberger's sixty-five-year career in technical assistance and education around the world. He has consulted for the US government, numerous individual nation states, as well as institutions such as the US Agency for International Development, the World Bank, and the International Monetary Fund. Of equal importance is his career as a scholar, from his training and interest in international trade to his work in public finance, especially project evaluation and benefit-cost analysis. Throughout, this oral history explores his lifelong pursuit of "real-world economics," research that both draws from and supports economic policymaking.

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Session 1A, Morning

01-00:00:00

Burnett: This is Paul Burnett interviewing Dr. Arnold Harberger for the Economist Life Stories Project for the Oral History Center of the University of California, Berkeley, in conjunction with the Becker-Friedman Institute at the University of Chicago. And this is our first session, September 21, 2015. Dr. Harberger, welcome. Let's start right at the beginning. Can you tell me a little bit about your family background?

01-00:00:36

Harberger: Okay. Well, I grew up in Irvington, New Jersey, which is slightly west of Newark. Actually, the other end of our street was Newark and our part of the street was Irvington. When I think back on those times compared with now, it's just incredible how free we were. I led almost a Tom- Sawyer life in my youth. We had to get back home for dinner or for lunch as the case may be, and summer nights we would go out and go and play softball on a lot near the corner, and after that troop up to a drugstore, and for 10 cents buy ice cream sundaes but be back by 10:00. And parents never worried about anything. With my friends I would go on bicycle rides five miles, 10 miles, walk anywhere you want, and never worry about security or anything like that. It was fabulous. And when I see how my granddaughters have to be shuttled around by their parents to meet this friend or that friend or do this thing or that thing, I just look back and think I grew up in heaven [laughter].

01-00:02:07

Burnett: [laughter] Do you think that has an impact on kids? Do you think that being allowed to go out by yourself —

01-00:02:16

Harberger: I certainly do think so, yes. And I should say certain aspects of myself were early revealed. And one story I sort of still cannot believe. I went to grade school at Florence Avenue, which was about a mile from home and my mother took me to kindergarten, and then came to pick me up and bring me home. And one time I hid behind a tree at five years old. And she didn't know what to do, and she walked home. And I walked home by myself. And after that they let go, allowing me to walk alone at five years old. Most of the time I would be with people from the block or something like that, but they were willing to give me that degree of freedom.

And I had this thing all my life: by myself I have to do it. And that was so early revealed. The other thing from grade school was that when I was in maybe seventh grade — what, I would be 11 years old, some guy rides up in a car and stops and talks to me and convinces me to sell *Liberty* magazine. And so from my 10, 11, and 12 years of life one day a week I would go around

delivering *Liberty* magazines to people that I had convinced should buy it. And the rest of my time I spent knocking on doors and trying to get new customers for *Liberty* magazine.

01-00:04:19

Burnett: [laughter] What was *Liberty* magazine?

01-00:04:21

Harberger: The editor was Bernarr McFadden, who was kind of a half-crazy guy into physical culture and all that, but it was a weekly that had mostly news and human-interest stories. I don't think we have a direct counterpart of it today, but it would be succeeded by something like *Time Magazine*. But *Time Magazine* was much more intellectual than was *Liberty*.

01-00:04:52

Burnett: Well, physical culture would have been almost kind of eugenics and health —

01-00:04:57

Harberger: That's exactly—

01-00:04:58

Burnett: — that kind of thing, right.

01-00:04:59

Harberger: Where you exercise and [laughter] ... goodness knows [laughter].

01-00:05:04

Burnett: Interesting. So that would have been in the mid-30s because you were born in 1924. Is that right?

01-00:05:10

Harberger: I was born in '24, yeah.

01-00:05:11

Burnett: Okay.

01-00:05:13

Harberger: And I graduated grade school in June of '37.

01-00:05:17

Burnett: Okay. So this is the Great Depression.

01-00:05:21

Harberger: This is the Great Depression, yes.

01-00:05:21

Burnett: Do you have any recollections, because when the crash hit you would have been five years old, when you walked home from school?

01-00:05:29

Harberger: I was actually very lucky. My father worked for the Ford Motor Company in Edgewater on the Hudson River, and commuted back and forth to Irvington.

And he basically got through the Depression with only one scare. This one time he came home and said he had been laid off. And I don't think he was laid off a week before [laughter] he was called back. And everything else then just went smoothly through the Depression. My grandfather was a photo engraver and he was a member of the union, the Photo Engravers Union. And he was laid off for most of the Depression, but he received a pretty good stipend from the union.

And so we had — I lived with my maternal grandmother, grandfather, father, mother, brother and me; six of us were in the second and third floors of what was basically a two-family structure. My other grandmother had the first floor [laughter]. So I grew up with five adult supervisors, so to speak. But family life was really very, very pleasant, and was orderly, and all of that. We had our music lessons, and we had to practice, and we had to do things and had to be on time, and all of that.

But as I think I've already indicated, we were given a lot of support, and a lot of freedom to do whatever came naturally, so to speak. My brother and I, when we get together we are always immensely grateful for our family life. The social life of the family was organized around the church. The church was where my mother and father had met. It was a church that had a German service and an English service. And two of my grandparents, maternal, had come from Bern, Switzerland, and the other grandmother had come from Stuttgart in Germany. And her husband, who was already dead, had come from Vienna. So the church had been a meeting place for people of German linguistic extraction. Not all from Germany by any means, and just all of the visiting was with people linked to that church. We had practically no link to anybody else.

There was one family, the Thomas's, who came over, who had been neighbors to my grandparents when they lived in Newark. And so there was that one instance of a non-church related social connection. But in any case, it was all a very lucky, lucky childhood.

01-00:09:15

Burnett:

And were you active in the church as a boy? Did you participate? Was it Sunday school kind of stuff?

01-00:09:21

Harberger:

Well, I mean my grandfather had been superintendent of the Sunday school. Well, when I was growing up it was my father who was superintendent of the Sunday school, and my mother was superintendent of the primary Sunday school. My father directed the choir, and was the organist, and treasurer of the church [laughter].

01-00:09:43

Burnett:

So I have a picture now of a deep involvement [laughter].

01-00:09:45
Harberger: [laughter] Well, it was not in any sense casual. And —

01-00:09:52
Burnett: Musically. Were you musically inclined?

01-00:09:54
Harberger: Well, I won the music prize in high school, but I didn't deserve it [laughter].

01-00:10:01
Burnett: [laughter]

01-00:10:02
Harberger: I won it because I had been one semester more in musical organizations. We had an orchestra, we had a band, we had a concert band, and we had a glee club. So we had four musical organizations. And there were much better musicians than I who had been in three of the four or had been in all four, but for less time. So I got the prize because [laughter] I had been for the most number of semesters [laughter] —

01-00:10:39
Burnett: [laughter]

01-00:10:39
Harberger: — in these organizations.

01-00:10:44
Burnett: So a quantitative measure of success in that domain?

01-00:10:46
Harberger: Right.

01-00:10:49
Burnett: So it's the mid-30s and you've finished grammar school, I suppose and of course, looming large in that story I suppose is World War II?

01-00:11:08
Harberger: Well, that doesn't come quite. When war had broken out, I was already at Hopkins. So the other thing with the high school time is working for Berry's Market. Our school had a double-shift. So we went to school in the afternoon as freshmen and sophomores. And junior and senior years, we went to school in the morning. And the school lasted only four and a half hours. It was a large high school, with about 4000 students, 2,000 per shift.

01-00:11:55
Burnett: Wow.

01-00:12:01
Harberger: So in my sophomore year, I guess, I got this job in a — we don't have stores like this, but it was a butcher shop let's say. But a butcher shop which sold groceries, and sold vegetables, and foods, and really everything. And I was

also doing everything, waiting on customers, and re-stocking the shelves, and taking the bad leaves off the wilted lettuce [laughter] and the heads of lettuce would shrink [laughter] through the week.

01-00:12:50

Burnett: [laughter]

01-00:12:54

Harberger: And delivering orders and the horrors were on what my mother called the equinoctial storms, which were the semi-hurricanes around September and so on of each year. And these storms would come and nobody wanted to go to a store. So everybody called their orders in. And so [laughter] those days you were out there in the rain three, four hours at a time. My pay was \$3 a week for 20 hours, four hours a day, five days. And when I worked on Saturdays I got an extra dollar for a 12-hour day [laughter].

01-00:13:45

Burnett: That was your overtime?

01-00:13:47

Harberger: And but I got tips on the orders, so it was a little bit more. But I certainly turned out to be a pinch penny. There is no doubt about that. But part of the origins of that lay in the fact that I was really working.

Now another aspect of this was that I was always pretty much at the top of my class, and but I didn't want to be a nerd. I didn't want to be superior to everyone; I wanted to be like other people. And so in all these respects like the playing softball on the lot, and going to the drugstore with the rest of the kids, and being like the rest of the kids was a genuine urge on my part. And this element of working like that, I think fits into the story that it wasn't that I was bookish in a sense of hiding myself from the world, and studying hard and all that.

In high school I did most of my homework between arriving at my desk, maybe half an hour [laughter] and the start of classes. It was different. And with all the extra-curricular activities, I didn't have time. And the work, I didn't have time to do homework at home [laughter].

01-00:15:43

Burnett: [laughter] But what were some of the aptitudes you said you were good — were you good at everything, or were there things that you were particularly attuned to?

01-00:15:53

Harberger: Well, let's see. In high school I won the math prize, the music prize, the Spanish prize. What other prize did I win? I won one prize for scholarship and also the history prize. So one thing that I took a so-called classical curriculum, which was had Latin three years, but basically no science. And I somehow always regretted that aspect of it. But I so appreciate the Latin. People who

have studied Latin really understand the structure of language, and they truly — grammar is something that those who haven't been through Latin really don't understand in depth [laughter], but those who have had years and years of Latin really have a feel for the structure of language.

01-00:17:15

Burnett: Right. Right. And you were good at all these different things? What did you like? Did you like them all equally?

01-00:17:27

Harberger: Boy, that's hard to say. I would say in Spanish we say *a la carrera*. It's running all the time and you're catching up with this, that, and the other thing. And I enjoyed pretty much everything. Certainly I enjoyed math. Certainly I enjoyed history. Maybe if I had times when I would be a little grouchy about doing something, it might be working through Virgil in Latin.

01-00:18:15

Burnett: Right, [laughter] yes.

01-00:18:15

Harberger: [laughter]

01-00:18:16

Burnett: Yes.

01-00:18:16

Harberger: There are some of those sentences... [laughter].

01-00:18:19

Burnett: One could be forgiven for being a little grouchy in that respect, yeah. But the family was supportive, and perhaps requiring you to make sure your homework was done and that kind of thing?

01-00:18:30

Harberger: Well, they never — I was completely self-motivated in that respect. And I never needed any pressure from my family, and did not want their help [laughter].

01-00:18:43

Burnett: Right going back to kindergarten [laughter]? Yeah?

01-00:18:46

Harberger: Yeah [laughter].

01-00:18:48

Burnett: And the school was good? And it was a public school that provided support?

01-00:18:54

Harberger: Both great. I mean I was parsing — diagramming sentences in 7th grade. And today kids get through high school and they have never diagrammed a sentence. And in high school we had excellent, excellent teachers. My kids

both went to the University of Chicago Lab School [University of Chicago Laboratory School] for example. I don't think they got a better education than I did.

01-00:19:29

Harberger:

What's also true, but the way that here the Depression had come into play because in life in almost every country people complain, but here we send, we train so many teachers and only half of them turn out to be teachers. And our answer as economists is yeah, but the ones who are not teachers are earning twice as much as the teacher [laughter]. So the education is paying off. They are happy. So in the Depression time it was the best [laughter] that were in the school you see. And in later times many of the best have filtered up into higher-paying jobs.

01-00:20:24

Burnett:

So there was a —

01-00:20:26

Harberger:

So we had excellent, excellent teachers.

01-00:20:27

Burnett:

An unintended consequence of the Depression —

01-00:20:29

Harberger:

Right. Right [laughter].

01-00:20:30

Burnett:

— was the investment in human capital in the [laughter] 1930s.

01-00:20:32

Harberger:

Exactly [laughter].

01-00:20:36

Burnett:

Well, it sounds like you had in a sense a kind of idyllic childhood. One that was, I mean it's an urban environment —

01-00:20:46

Harberger:

Suburban, really.

01-00:20:50

Burnett:

And with — it's a kind of German enclave.

01-00:20:53

Harberger:

No, no.

01-00:20:54

Burnett:

Not at all?

01-00:20:54

Harberger:

The neighborhood was — we were three miles from the church, so there was no neighborhood aspect to the church. We had to drive to church.

- 01-00:21:10
Burnett: Okay, so there were two separate communities that you had access to?
- 01-00:21:12
Harberger: That's correct. The neighborhood was one where my friends were all neighborhood kids and the church was something that we went to on Sundays, and for choir practice on Friday nights, and so on. Yeah.
- 01-00:21:28
Burnett: And your father worked for the Ford Motor Company and —
- 01-00:21:31
Harberger: Correct.
- 01-00:21:31
Burnett: — he was a manager or?
- 01-00:21:34
Harberger: No, he was sort of an accountant.
- 01-00:21:35
Burnett: Accountant?
- 01-00:21:35
Harberger: Yeah.
- 01-00:21:37
Burnett: Okay. So he had been to college?
- 01-00:21:40
Harberger: No, he had not been to college. My father went to some kind of a business school after grade school. And that's all the education that he ever had. My mother had two years of high school, but they were very literate. And my grandfather, who emigrated from Bern, he was the one who bought all the books in the family. And he was more the — mother and father were neither bookish, but grandpa was and so that was it.
- 01-00:22:19
Burnett: Was there a kind of influence of that? I mean, there's Chicago studies about the presence of books in the house, and how that's correlated with success in life?
- 01-00:22:28
Harberger: Well, that certainly helped me. I remember there was a big volume with gold letters on the outside and so on, *Fifty Centuries of the Human Race*, that my grandfather had bought. And it really was a universal history, but very much Western-oriented, leaving out China, India, and all that [laughter] —
- 01-00:23:00
Burnett: Right [laughter]. Right. Yeah.

- 01-00:23:00
Harberger: — so within the Greco-Roman tradition. It was pretty complete from Egypt on.
- 01-00:23:06
Burnett: So that was an important influence, and your grandfather was. It sounds like multiple generations were involved in raising you and —
- 01-00:23:16
Harberger: Yes.
- 01-00:23:16
Burnett: — mentoring you —
- 01-00:23:17
Harberger: Exactly. Exactly.
- 01-00:23:17
Burnett: — and providing you with opportunities to see new things. And you're not too far away from Manhattan. Did you trip into the city to see the sights?
- 01-00:23:30
Harberger: That came a little bit later from when, by the time I was going to college, I then made frequent trips to New York by myself. And my grandfather often went to New York alone to the art museums and things like that. He was an artist too, a painter.
- 01-00:23:46
Burnett: Really?
- 01-00:23:46
Harberger: And he had been — he was the son of an owner of a bakery of some significance in Bern, but who then went bankrupt. And grandpa had to tend sheep in the Alps [laughter] in the summer, and so on to sort of fortify the family income. And he won a scholarship to art school in Italy —
- 01-00:24:24
Burnett: Wow.
- 01-00:24:24
Harberger: — but it was just a tuition scholarship, and there weren't the funds to keep him there. And that led him to migrate to the states, but my grandmother had immigrated earlier, and he came chasing her [laughter] I think.
- 01-00:24:46
Burnett: Really [laughter], they actually —
- 01-00:24:47
Harberger: They got married here.
- 01-00:24:48
Burnett: Okay. Do you remember when that was?

- 01-00:24:51
Harberger: Well, in the 90s. The 1890s.
- 01-00:24:56
Burnett: Wow. And so were you then the first in your family to attend college?
- 01-00:25:03
Harberger: Yes.
- 01-00:25:05
Burnett: Okay. Did you have siblings?
- 01-00:25:07
Harberger: I had my brother who followed me. He was five years younger. And he got a master's degree in math and he worked in Redstone Arsenal in with Rohm and Haas Chemical Company. And he became a vice-president of personnel there, and took early retirement, and had a consulting firm in high sort of scientific personnel management which went on for about 20 years before he retired from that activity.
- 01-00:25:50
Burnett: So you were doing well in school, and was it a foregone conclusion that you would attend college? Was this —
- 01-00:26:03
Harberger: In my mind it certainly was [laughter].
- 01-00:26:06
Burnett: Yeah [laughter].
- 01-00:26:07
Harberger: No doubt about that [laughter].
- 01-00:26:08
Burnett: [laughter] But not all families, or not all family members are supportive when it's the first going.
- 01-00:26:17
Harberger: Well, in this case everybody was. It was kind of taken for granted. The mere fact that I was taking this classical curriculum that was a college-prep curriculum but when I got to Johns Hopkins, that's another thing. The vice principal of our school sort of became interested in my case, and helped a lot in guiding me to where to apply, and all of that. And I won a national scholarship from Johns Hopkins [Johns Hopkins University] that paid my tuition for what would have been for four years if I had stayed four years. But you know what tuition was at Hopkins at that time?
- 01-00:27:12
Burnett: What was it?

01-00:27:12

Harberger:

Four hundred dollars a year. Four hundred dollars *a year* [laughter] for — and this was the same at Harvard, Princeton, Columbia. They were all around, somewhere around there. So but I was interviewed for this scholarship by the provost of the university. My grandfather took me over to New York in some hotel and we met with P. Stewart Macauley.

So when I arrived on Hopkins campus as a freshman I knocked on the door of P. Stewart Macauley, the provost. And I went in to see P. Stewart Macaulay. That was my first higher-level visit on campus. And then I was free to register for as many courses that I wanted. And I took seven instead of four or five my first year. And about month later I was called in by whom, the registrar. So Irene M. Davis, registrar, [laughter] interviewed Arnold Harberger [laughter] and ended up letting me take all seven courses, and I did — got A's in all of them and so —

01-00:28:31

Burnett:

So you were counseled against it? They said this is going to be too much?

01-00:28:34

Harberger:

She was worried, but by my last semester, I was taking 10 courses.

01-00:28:43

Burnett:

Do you remember the courses that you were — what provoked you to take those seven courses? Was it the range of them that you were interested in?

01-00:28:50

Harberger:

Let's say I am the most worldly of my family. And for all the love, and warmth, and everything of my environment, the constrictions provided by the church, and this and that and the other thing, they bound a bit, you see. So I get to Hopkins, and I'm *free!* [laughter] —

01-00:29:33

Burnett:

[laughter]

01-00:29:33

Harberger:

— and I'm just gobbling up everything. That was the feeling of it. And as long as I could do it, I would do it.

Now one thing I'll say, we were all rushed for fraternities, and I didn't even dream of joining a fraternity. That's a waste of time. I'd rather take more courses. And then I was on the newsletter. The newspaper only came out once a week, thank God, but I was a reporter. I only was there for 19 months, and I almost finished. Had I finished that term, I would have finished in less than two years.

01-00:30:17

Burnett:

Oh, my goodness.

01-00:30:19
Harberger: I came in September, and the second June I would have finished, if I'd finished all those ten courses.

01-00:30:28
Burnett: And the regular complement was four courses a semester or five?

01-00:30:30
Harberger: Four or five depending on what people registered for. So in any case I was a reporter, and then copy editor, and then news editor of this paper all in this short time. And I then, we mentioned Ludwig Moser. He was a son of a Dutch art dealer and they lived on Central Park South in New York —

01-00:31:06
Burnett: Wow [laughter].

01-00:31:06
Harberger: — in a very elegant apartment and all of that. Well, when I visited them, there were Dutch masters and impressionist masters all over the walls. Incredible! [laughter] So he somehow found me. And he was a true intellectual, and very much in the European style, and very conscious of being an intellectual and not very charitable to non-intellectuals [laughter]. And so he grabbed onto me, and I think brought more culture to me than came from any other particular individual source. He had all this background and so on. So, this is during the war, and I was president of the International Relations Club. And in Hopkins there had never been a black speaker. The last time a black speaker had been invited to come to Levering Hall, which was kind of a union club thing, the doors were locked, and his speech took place in a park which was immediately adjacent to Hopkins, but it was an open-air speech.

Well, in our conversations with Moser we decided that the International Relations Club would invite a black speaker, and we did. And the black speaker came to Levering Hall, gave his speech, no problem. Roosevelt was talking about all sorts of things, and we were all in this together kind of in the war, and it was just something they could not do.

So now, in my role in the newspaper, I had to fight with the editor, but I ended up writing a 50-inch story on the [laughter] — how great was this event. And I'm still proud that we were able to do this. I think I may have exaggerated impact or importance, but it certainly is something that stands out in my period there at Johns Hopkins.

01-00:34:20
Burnett: Do you remember what the subject of the talk was?

01-00:34:22
Harberger: No. And he was from, I think it was called Knox College. It's just down the road practically from the Hopkins campus in Baltimore.

01-00:34:33

Burnett:

Right. And so it was a — you were aware of some of the tensions and the, I guess the divides in the United States?

01-00:34:42

Harberger:

Yeah, well, I got some of this from Moser, I mean he made me a left-wing intellectual at that time. And during my period in the Army, I got *Time* and the *New Republic* delivered to my Army address all through the war. And this is how I sort of kept links to what was going on in the world, and political events, and goodness knows may have helped promote the decision that when I got out of the Army and went to the University of Chicago, I was in international relations, rather than in economics. Well, at Hopkins my major was economics.

01-00:35:41

Burnett:

It was?

01-00:35:41

Harberger:

Yeah.

01-00:35:41

Burnett:

Okay. Yeah, and I was going to ask because you said you had had this classical education earlier on, and that was a kind of preparatory curriculum to get you into college. Where does the switch over to economics happen when you're at Hopkins? How does that take place?

01-00:36:07

Harberger:

Well, no, it didn't happen at Hopkins. It happened in high school. We had a one semester course in civics, and a one semester course in economics in senior year of high school. And the economics teacher was Professor Long or Mr. Long and he was a very inspiring person. And he insisted that everybody in the class subscribe to the *New York Times* and build a scrapbook of stories from the *New York Times*, one per day with comments on the stories. And I was very much inspired by that. And I'm sure that was the reason why I chose economics as my major upon arrival, so to speak, at Hopkins.

01-00:37:11

Burnett:

What was your sense of what economics was, doing those kinds of exercises? What was the promise of it for you at the time?

01-00:37:20

Harberger:

Well, I mean, a science of people that's for sure. That, and, this is going to be a pervasive element I think in all of our conversations [laughter], because it was not the beautiful, mathematical symmetry of economic theory that drew me to economics; it was the fact that it dealt with people, it dealt with real economic problems, and so on, that attracted me.

01-00:38:05

Burnett:

At the time there's a great deal of optimism and enthusiasm about the social sciences in general. Not just economics, but other forms of social inquiry. So

people were doing sociology, some people were doing anthropology, and these were also sciences of people, but this is something special. And it's not, I mean you can say that it's not the symmetry of the mathematics that's attractive to you, but there's something special. Is it because it's about economic matters that seem to be so —

01-00:38:44

Harberger:

Well, I think there, if you want to distinguish from sociology at that time, it is certainly— I would be much less attracted to sociology because of its lack of structure. The element of rigor that pervades economics is there for the super-math people, but it's also there for people like T. W. Schultz and me, and Friedman, let's say, to give you a few names.

01-00:39:22

Burnett:

So it had that element of the structure, and perhaps your early interest in Latin —

01-00:00:23

Harberger:

[laughter]

01-00:39:31

Burnett:

— thinking about, not to stretch too much, but —

01-00:39:35

Harberger:

[laughter] Right. I get the idea. Yes. Yes, of course.

01-00:39:39

Burnett:

What's striking about it is that mathematics is a language, right? And you're translating into these structural forms something that's really messy and complicated. And language can be pretty messy [laughter] and complicated.

01-00:39:52

Harberger:

Yeah, yeah. [laughter]

01-00:39:54

Burnett:

And so there's perhaps an element of that. So it begins the interest in economic thinking, and social subjects that are connected to economics in one way or another that's spurred by this high school teacher —

01-00:40:09

Harberger:

Yes.

01-00:40:10

Burnett:

— and those exercises.

01-00:40:11

Harberger:

Originally. Yes.

01-00:40:12

Burnett:

And reading the newspaper, the newspaper of record of a certain kind, the *New York Times*, learning about the complex changes in the world. That's a

really important aspect of the attraction. And so when you go to Hopkins, you're taking different kinds of courses, but you end up majoring in economics in your undergraduate. But that is interrupted, right? Or the war kind of gets in the way a little bit?

01-00:40:44

Harberger: The war [laughter] interrupted that whole process, yes.

01-00:40:47

Burnett: [laughter] That's right.

01-00:40:49

Harberger: And I appealed to the draft board in Irvington, New Jersey, to, please let me finish the semester, then I would finish Hopkins. But they said, "No." And so I was inducted on, I think the 3 of April of 1943, and went by train to Anniston, Alabama, where we had basic training for three months. And then after basic training, we went through a battery of tests. And, crazy as it may seem, out of this battery of tests came that I was a Spanish linguist.

01-00:41:33

Burnett: [laughter]

01-00:41:35

Harberger: [laughter] And I had taken Spanish in high school. The actual choice came in the tenth grade, when you had to choose whether to take French, German, or Spanish? And I took Spanish, largely I think because I had Latin and Spanish was the one that made greatest use so to speak of my Latin inventory [laughter].

01-00:42:12

Burnett: Right [laughter].

01-00:42:15

Harberger: And so I got to Hopkins, and I took a course the first year. I did well. And the professor gave me a reading course over that summer. I read about 10 books and wrote reports on them. And then I, by the second year that I was there I was in a graduate course in Spanish with Pedro Salinas who was one of the great Spanish poets of the time, who had been exiled, or voluntarily exiled from Spain. And he was a great inspiration and great person. So this gave me a background which somehow enabled the Army filter process to label me a Spanish Linguist. Well, they had actually the Army Specialized Training Program, ASTP, undergraduate programs teaching Spanish, strangely. And they had them teaching Chinese, and teaching Bulgarian, and goodness knows what else, but —

01-00:43:24

Burnett: Sure.

01-00:43:24

Harberger: — I was too advanced in Spanish for such a program.

And so I was put in this language pool where we had Romanians, and we had Russians, and we had many Germans, and Dutch, and French, and all of them sitting there in Champaign-Urbana at the University of Illinois each charged with writing what would be a master's thesis.

So I wrote this thesis on the latifundia in Spain, and wondered well, what the hell were they doing having Spanish linguists? Well, there was the possibility that Franco would enter the war on the German side. The second possibility is that we would invade Europe through Spain. So between those two things I think we would find the motivation. So the program lasted until March of '44 when the war was really revving up, and we're invading Europe, and not in Normandy, but in Sicily and all that.

01-00:44:39

Burnett:

Right, sure.

01-00:44:42

Harberger:

And so at that time, the program broke up. In all its wisdom, the Army said that if somebody is eligible for overseas service, you can classify him any way you want, but if he is limited to the continental limits of the United States, he must be using what we have been holding him for as a linguist.

So there were several of us who, mainly because of eyesight, were ineligible for overseas service at that time. And we were sent to Fort Custer in Michigan, and we spent about six weeks doing nothing but play bridge, and because they couldn't find a place within the continental limits of the United States where they needed Spanish linguists [laughter].

And so one day the colonel calls me in and says "You went to Johns Hopkins?" I say, "Yes." "You studied Spanish there?" "Yes." "Do you take any other languages?" Yes. "What other language?" "German." "How much German did you take?" "One year." "What grade did you get?" "A." "Ah, starting tomorrow you're a German linguist." [laughter]

01-00:46:06

Burnett:

[laughter]

01-00:46:07

Harberger:

And that was the absolute truth. The following day I was on a train to Camp Ellis, Illinois, where I report to another colonel. And this colonel says. "You're the new German linguist?" I [laughter] said. "Yes." He said, "Well, you're in charge of Company 12 of prisoners of war. You go through this double barbed wire fence, and you go down the southwest corner, and you're going to find an orderly room there. And in that orderly room, you will find *Oberfeldwebel* Schnellbaecher and *Unteroffizier* Knerr [laughter]. And they are the German staff of this company." So I go and I enter this thing, and I get a "Guten morgen, Herr Harberger!" [laughter]. That's where my German education began [laughter].

01-00:46:58

Burnett: [laughter]. Did you have any? Was there any German language spoken in your family, your grandparents?

01-00:47:02

Harberger: Only when they had secrets from the kids [laughter].

01-00:47:07

Burnett: [laughter] So that didn't help you and that's it?

01-00:47:12

Harberger: That didn't help, but nonetheless I think from the church services that I only went to English services, but I don't know, there was some element that the German pronunciation did not seem unnatural to me for example, and things were okay.

And so from April of '44 or maybe it was early May by the time I got there until August of '45, I was in this prisoner-of-war business. First at the company level, and then I moved to battalion headquarters. We had 3,000 prisoners and there were three battalions each of about a thousand. And they did all the work on the base. They did the kitchen, the cooking, and the washing of dishes, and the carpentry, and the painting, and this and that and the other thing. And we also sent them out to work in contract for private people. They did harvesting corn, and packing peas, canning peas, and things like that.

And so then when the war ended, and we sent them back quite early from Camp Ellis, I was sort of without a job at that point. And I was appointed to help audit the books of the prisoner-of-war camp in Fort Sheridan, right outside of Chicago. And so I spent the last months, until March of '46, doing that auditing work. And it was very good because we could live off of the base, and were right in Chicago. And there's no question in my mind that that final assignment is the main reason why I went to the University of Chicago you see. I got out in March, and I would have had to wait until September to go back to Hopkins, a terrible waste of time, so I actually started in international relations at Chicago five days after I was discharged from the Army [laughter].

01-00:50:04

Burnett: So you were impatient; you had had your studies interrupted, and you wanted to just get done as quickly as possible?

01-00:50:12

Harberger: Didn't want to waste time, certainly.

01-00:50:16

Burnett: And so Chicago, it was just serendipity? That was the last place you'd been stationed and—?

01-00:50:26

Harberger:

Well, I was aware. I was still interested in economics, but was going into international relations. And I was aware, for example, that Jacob Viner was a famous economist who was at Chicago at the time. By the time I actually arrived, he had left for Princeton. But [laughter] such is life. But Friedman then came.

01-00:50:53

Burnett:

And just out of pure curiosity, the work with the prisoner-of-war camps, was there any question of the integration of the prisoner-of-war camps into the local community? Was the community hostile to these folks or was it something that was completely separate?

01-00:51:15

Harberger:

Well, number one, our prisoners were mainly *Afrikakorps*, but it doesn't really matter. All through the war, we were shipping soldiers overseas, we were shipping all the equipment, most of the food, everything for them overseas. If we kept prisoners overseas, we'd have to ship the food and supplies for them. We'd have to use our people there to watch them. This way, when we put them back here in all of our camps where we're training people, we're freeing those people to be trained rather than to wash dishes and peel potatoes, and so all of that work is being done by prisoners. And we are able to feed them a lot cheaper than if we had them anywhere in Africa, or in southern Europe, or whatever and, next, if they escape [laughter] they're not going to be able to swim the Atlantic. So their incentive is bad.

But I have to tell one story. We had a side camp in Hoopeston where we were canning mainly corn I think at that time, Hoopeston, Illinois, and we would go out with maybe 30, 40 prisoners and maybe six or seven of us. And anyway one morning we find one of the prisoners is missing. And we were distressed and we're looking, and so on. Well, turns out that Saturday night a couple of our guys go into a nightclub, and there, playing the drums in the band is, who? This prisoner [laughter]! Well, he got 30 days on bread and water which was the standard punishment for such offenses. And his answer to that was "Anytime. Anytime!" [laughter].

01-00:53:45

Burnett:

[laughter] He just needed to play some music? It was that important. That's fascinating.

So you happened on the University of Chicago. Can you tell us a little bit about— this is now international relations? So that's a kind of separate thing. Now, by this time the undergraduate training has been segregated into a college, right? Is that right?

01-00:54:16

Harberger:

That is correct.

01-00:54:18

Burnett: Okay.

01-00:54:18

Harberger:

We had the college and the divisions, as they called them. And the typical degree was a PhB, Bachelor of Philosophy, which was a two-year degree, which in the Hutchins System was followed by three years for a master's in your specialization. So I entered mid-point in that three years, as my priors at Hopkins put me ahead of the PhB level, but not at the master's level.

So I entered there in March of '46 and got my MA in December of '47, but by that time I had already shifted to economics. And I shifted to economics early in the fall quarter of '47, because I was too distressed by a course in international law that I was taking, and that I thought I would have to pursue further if I stayed in international relations. And —

01-00:55:35

Burnett:

What was distressing about this course?

01-00:55:37

Harberger:

Well, Quincy Wright taught that course. And he was famous and good, but I remember we were to have a series of cases, hypothetical cases that we were to then write opinions about using the international law of the time in which this case occurred. So our first case was something in the late 18th or early 19th century about hogsheads of molasses that had come from a, some kind of colony in the Caribbean, and was going in a British ship to a French destination, and there was this litigation about it. And I had to research all this stuff, and write this paper. And I did. And I typed it by myself and I finished it on a Sunday night. And I said, "Harberger, are you a man or a mouse?" And I don't know what the proper answer to that question would be because the following day, first thing in the morning I went to the economics office and said, "Will you have me?" [laughter] And he said —

01-00:56:59

Burnett:

So you didn't turn it in or?

01-00:57:01

Harberger:

Well, I probably turned it in, but I didn't finish that course and I shifted to economics immediately. It was early in the quarter, so I still had time. And from then on, it was fall of '47 and then I was in economics until August of '49. I was less than two years in economics at Chicago.

01-00:57:32

Burnett:

So the irony being, however complicated that case was, it pales in comparison [laughter] to the papers that you'd write in economics in terms of the issues?

01-00:57:43

Harberger:

Oh, I don't think so.

01-00:57:43

Burnett: No, you don't [laughter]?

01-00:57:44

Harberger: [laughter] No, I mean the issue is if you're interest is in something that's one thing [laughter].

01-00:57:53

Burnett: Right, okay. Fair enough.

01-00:57:55

Harberger: If you think it a chore, it's quite another.

01-00:57:57

Burnett: Right, absolutely. So you were in international relations for that brief time and then you joined economics in pursuit of the PhD? And can you just, putting yourself back in that time, you had decided because you had taken during your AM period you had taken some economic courses that you knew you were attracted to that. Do you remember whom you were studying with or taking courses with?

01-00:58:31

Harberger: Well, of course I do. With whom was I taking courses when I was still in international relations are you asking?

01-00:58:53

Burnett: Yeah, I mean if there's a seed there that says this Chicago economics is for me?

01-00:59:01

Harberger: Well, certainly it was not Chicago economics that I was not —that distinction would not have been in my head at that time. But economics was always my minor within international relations. And I wrote my masters' thesis on economic aspects of German geopolitical thought, trying to capitalize on the German that I had learned during the war more than anything else. I mean I don't know if that was distinctly in my mind in choosing that topic.

And Hans J. Morgenthau and Bert Hoselitz were my two professors. Hoselitz was in economics, and Morgenthau was one of the leading people in international relations and for whom I have huge respect. He's kind of — he is one of the fathers of realist international relations, and that always did appeal to me.

So once I got into economics, I was taking courses with Friedman. The key influences on me were [Milton] Friedman, [Jacob] Marschak, and [T.W.] Schultz. Friedman taught price theory at that time. And I had two courses in price theory with him, a full sequence, and Marschak taught macroeconomics and gave a wonderful macro course which very strongly influenced— when you see model building in — I don't build complicated models, [but rather]

simple, gutsy models, the stimulation that led to that was more Marschak than anything else.

And T.W. Schultz, was so real-world. And so skilled at using simple economic concepts — he was not a master of price theory or of food production functions or this or that, but he did more relevant economics than almost anybody of his generation. And he was one of the great economists of his time. And certainly had a great influence on me.

01-01:01:40

Burnett:

And at that point, you're considered a graduate student. So this would have been economics in the graduate division?

01-01:01:48

Harberger:

That is correct.

01-01:01:48

Burnett:

Right. So and this is before a lot of stuff gets later in terms of what this thing called Chicago is as you've said, right, or it might be more historically accurate to say that it's between a kind of older Chicago, and what Chicago becomes in the late 40s and 1950s.

So, can you talk a little bit about graduate student culture at that time, how it worked? And you took classes. How did people interact? Was it simply through the classes, or was there some kind of organized sociality, some kind of organized social function that allowed people to get ideas from one another?

01-01:02:41

Harberger:

Well, let's start with this. We had, in economics at that time, like, 200 majors — 200 graduate students. And why it was so big was that all the generations who had been in the war were spilling out at the same time, in all the universities, and we had the GI Bill of Rights. Tuition was paid, and we received a stipend of \$75 a month, and with any scholarship you won at the University of Chicago, if you were a veteran, whatever was the official stipend of the scholarship, you got \$25 a month, nothing more. You got the supplement that brought the \$75 to \$100.

But what did we have? All these people were serious. They were much more motivated than the average undergraduate. The idea of fraternity parties, and goodness knows what; none of that. And I lived in a dormitory, Burton-Judson Dorm. And I had a roommate, Jim Johnston, who had been in with the OSS [Office of Strategic Services] in Chungking during the war, and I still visit with him when I go to Washington. We were roommates for well, from March of '46 until at least March of '49. I got an apartment of my own at some point there, but the — we had this long-term relationship, so to speak. And we'd go on long walks, and we ate at — in the communal dormitory style with a tray that they slop into the different compartments of the tray, this and that and the

other thing. And we never forget this one sort of Eastern European immigrant woman who doled out the soup. And we would always ask her what kind of soup do you have? And on certain days, her answer was, “Spit pleas!”
[laughter]

But the other thing is that we were surrounded by U of C [University of Chicago] undergraduates. And so there were the veterans on the one hand, and then these largely highly intellectual young people talking about Plato and Aristotle, and goodness knows what, and it was sort of an interesting juxtaposition there.

01-01:05:50

Burnett: I’m sure.

01-01:05:50

Harberger: Then somewhere along the line, about the halfway point of those three years they shifted the veterans out of the dorm into a two-story barracks-type arrangement with separate rooms. So Jim and I shared a room in what was called Manly House, right behind Burton-Judson. We ate at the same tables as before, and so on. But I think the intent of that was to put like with like
[laughter].

01-01:06:35

Harberger: There was just a difference in age, in experience, in what you were actually getting in your studies. For most of us, we were more graduate students. They were more undergraduates, and so on. So that’s how that ended.

01-01:06:57

Burnett: Well, it sounds like that’s a tremendous story in and of itself, right? You’ve got this bottled up supply of graduate students come out of the war. But there’s also a demand aspect of it as well. John Kenneth Galbraith recalled when he first came to Washington to work at the Office of Price Administration, he came onto the mall and he noticed there were all these Quonset huts. No idea if this is true or not. There are all these Quonset huts on the mall itself. He said, “What is that?” and his colleague said, “Oh, that’s where the economists are.”

01-01:07:36

Harberger: [laughter]

01-01:07:36

Burnett: [laughter] That’s because there was such a demand because market relations were more or less suspended for the duration, and were replaced by a system of administered prices. And you needed economists, and accountants, and clerks to do all of that. That’s just one feature of it. Did any of that kind of filter into the conversations about what people were going to do after the war? This was a new kind of profession that has risen to the top of society at that time. It’s doing this important work.

01-01:08:23

Harberger:

Well, I would say you find a lot of debate among economists whether even in war time you would have wanted that degree of control. On the other hand, I fully understand that — you were printing a lot of money, and did you want inflation to spill out somehow, and having ration coupons is a way of dealing with that, which is functional, even when people transact these ration coupons, and people sell ration coupons, and all of that. Okay, but that's different from everybody seeing a huge price rise and so on. So I am not as doctrinaire against the price controls in war time, but I am pretty doctrinaire against price controls most of the time [laughter].

01-01:09:42

Burnett:

[laughter] Right. But there was a — I mean that's weighing on people because there's this, as you're in school at Chicago as the demobilization is happening, as the release of the price controls, 1946 is this tremendous period of tumult, meat prices double, as the price controls are lifted. Five million workers go out on strike. So there's price instability, there's labor unrest, there's all of these things that seem to feed into the need for people who could understand and learn about the economy and those economic problems.

01-01:10:25

Harberger:

Well, what can I say? I don't think that myself and my fellow students and so on, did that impinge much on us? What was certainly the truth that if you study economics at Chicago, MIT [Massachusetts Institute of Technology], Harvard, Stanford, Yale, etcetera, and you were pretty good, you were going to be able to get government jobs, international organization jobs, academic jobs, and you would have a choice. It would not be that you only had you had to grab at your first offer, or anything like that. That there would be choices involved. And what was your motivation? Your motivation was to be as high in the hierarchy, so to speak, as you could, to be at the point where you were entering this market, because the market had its layers, and you could be ending up teaching at University of Southern Illinois Carbondale, or at Harvard [laughter]. There's a difference.

01-01:12:15

Burnett:

Right. [laughter] Absolutely.

01-01:12:17

Harberger:

[laughter] And so the motivation to work hard and so on and try to make — be noticed, so to speak, for what you were doing was there.

01-01:12:32

Burnett:

And so of course excellence is part of the package, I mean these are top people that are training top graduate students. But I was also kind of reflecting on the priority, in terms of deciding which problems, which economic problems are worth studying, are important questions of the day. And I'm thinking about the tremendous change that happened first of all, a kind of command-and-control economy during the war, then the kind of transition,

and the instability that causes. I was just thinking about how that might have affected folks.

And then other piece of it, I suppose, is at Chicago there were some figures — well, there's Friedrich Hayek, for example, I don't want to get ahead of ourselves too much, but in 1944 he publishes *The Road to Serfdom*, and that has a huge impact. And he's terribly concerned about the kind of slippery slope that the United States, or other industrialized nations might fall into moving towards planning, moving towards socialism, or indeed something worse. So was there conversation about that for example at that time when you were there?

01-01:13:58

Harberger:

Well, I think most of us had read Hayek, first of all, had read *The Road to Serfdom* at least, of Hayek. And without necessarily becoming religious fanatics on the subject, I think most people were on the side of that message. But what stands out in my mind is how absolutely little ideology we received in our graduate training at Chicago, and [from] Friedman most particularly. I had these two courses with Friedman. I don't think I got even, like, maybe little whiffs of *Free to Choose* and *Capitalism and Freedom* [that Friedman would publish in 1962], but these were two sides of Friedman's life, so to speak, that he kept quite distinct. And if we became convinced of the virtues of market economics, it was by studying the functioning of market economics rather than by becoming co-religionists, so to speak.

01-01:15:29

Burnett:

Right.

01-01:15:29

Harberger:

Yeah. Yeah.

01-01:15:30

Burnett:

I think there's a story, an apocryphal story about Friedman. Later in his life when he was teaching, a student asked him which came first: did politics drive your economic thinking or the other way around, did your economic or scientific understanding of how the world works shape your politics? And he said "Absolutely, the latter."

01-01:15:50

Harberger:

Absolutely right.

01-01:15:51

Burnett:

That's a story, at any rate. So you're studying, and you're influenced by Friedman. And price theory was — others have described price theory course as, it's kind of the basic course to understand how economics works.

01-01:16:23

Harberger:

I think that's correct. I mean it deals with the forces underlying the allocation of resources in the economy, and all that, supply and demand are the driving

features of that, and to me it's just amazing how you can take EC [economics] 1, and you learn about supply and demand. And then you take EC101 and you learn about supply and demand again. You see it a little more clearly. And then you get into Friedman's graduate course, and you get the same goddamn stuff again [laughter] —

01-01:16:55

Burnett: [laughter]

01-01:16:56

Harberger: — but at a depth. And it becomes part of your blood, so to speak, by the time he's finished with you.

01-01:17:07

Burnett: That's — the repetition is important, in a sense because you examine more closely —

01-01:17:11

Harberger: It's digging deeper, and getting more of the underpinnings of the story instead of the superficial story.

01-01:17:22

Burnett: And a gifted teacher.

01-01:17:24

Harberger: Tremendously gifted teacher.

01-01:17:28

Burnett: And for T. W. Schultz. Theodore Schultz had come to the University of Chicago in 1943 from Iowa State.

01-01:17:39

Harberger: Right.

01-01:17:39

Burnett: And he had resigned from that institution in part because of a political —

01-01:17:48

Harberger: Of Oswald Brownlee's article about oleomargarine being as good as butter [laughter].

01-01:17:53

Burnett: Yes, the oleomargarine controversy. So the USDA [United States Department of Agriculture] had commissioned this set of pamphlets, and these studies to be done, and the dairy industry in Iowa got up in arms about this —

01-01:18:10

Harberger: Exactly.

01-01:18:10

Burnett: — put pressure on the university. And Schultz, in response to that pressure, he left, went, took some folks, Brownlee, temporarily to Chicago, and a number

of others as well, D. Gale Johnson. Did he talk about or reflect on that transition during that time?

01-01:18:30

Harberger: No.

01-01:18:30

Burnett: No?

01-01:18:33

Harberger: I only had one course with him, actually. And so, it was not — it was the power — well, I only had one course with Marschak; I had two courses with Friedman [laughter]. So there you go.

01-01:18:53

Burnett: Yeah. And so you were — complete the AM, and by fall of —

01-01:19:07

Harberger: Fall of '47 —

01-00:19:00

Burnett: Fall of '47.

01-00:19:07

Harberger: — I got my master's degree, right.

01-01:19:09

Burnett: Okay. And then you take the graduate courses, and there's a doctoral thesis subject that you embark upon. Before we go into that, actually, are there other notable graduate students in that cohort who then go on at Chicago that you recall?

01-01:19:31

Harberger: Jim Buchanan was a year ahead of me. And he certainly was famous in our market year, so to speak. Warren Nutter and I were the two main stars, so to speak — we had offers from good places and so on. And Nutter and I got just about the same offers [laughter]. And he went to Yale, and I went to Hopkins.

01-01:20:16

Burnett: Okay.

01-01:20:17

Harberger: And he ended up in government in the United States, and was very — it was he, who by his study of the Russian economy, found our intelligence agencies were greatly exaggerating the strength of that economy. And he fought an almost lonely battle for many years trying to convince people of his position. And he was right and they were wrong.

01-01:20:59

Burnett: Right. And Jim Buchanan of course goes on to be famous for public-choice theory, and all of that—

01-01:21:05

Harberger: Exactly.

01-01:21:05

Burnett: — as well. And one more piece I think that we should talk about is—I put in my notes here, the actual physical address of the economics department because I think that physical space, where things are located in relation to other programs is important. Can you talk a little bit about the building, what was there, what kind of activity people were engaged in? The fourth floor is the economics department.

01-01:021:34

Harberger: Yeah, 1126 East 59th Street.

01-01:21:36

Burnett: That's right [laughter].

01-01:21:42

Harberger: Well, I think that as universities go the University of Chicago has a particular character to it. And it may come from its very founding late in the game, see it was only founded in '92 or something like that.

01-01:22:16

Burnett: Yeah, that's right.

01-01:22:18

Harberger: Eighteen ninety-two. And it was founded with a ton of money with a purpose of attracting the very best of anywhere in the world. And the idea that a university, the way you're supposed to do it is publish articles in refereed journals. "How many articles has this man or this woman put into refereed journals? And this other one?" I was on the faculty in economics for 38 years, and I never heard a remark like that. And you go around to other universities, even very good ones, and you're going to hear remarks like that.

In Chicago it's always: what has he or she contributed to knowledge? What have we learned from this person? What have I learned from this person? And that aura is just all through the walls of 1126 East 59th Street. The idea that you're going to be doing something trivial at the margin, or something like that, is anathema to those guys.

01-01:23:50

Burnett: Right. And so intellectual discussion and conversation is something that's happening everywhere in the halls, and there's also something that happens not too long before you get there is that there is statistical laboratories that are set up in the building. There's two statistical laboratories, and then there's the Cowles Commission?

01-01:24:17

Harberger: Well, that comes later, and we'll talk about that later.

01-01:24:18

Burnett:

Let's talk about that later. Okay, then. So but there's this — there's an environment that's part of the long history of the University of Chicago as a whole, that this is supposed to be a real contribution to original research, but less of an accounting of excellence but more a kind of understanding of the quality of contribution to new debates seems —

01-01:24:45

Harberger:

Yeah.

Session 1B, Afternoon

01-01:24:58

Burnett:

This is Paul Burnett interviewing Dr. Arnold Harberger for the Economist's Life Stories Project. The Oral History Center, the University of California, Berkeley, and the Becker-Friedman Institute. And we're continuing on our first day, September 21, 2015.

So you had finished your Master's in International Relations at the University of Chicago, and you had switched over to economics, and had taken the requisite graduate course including price theory, and you'd studied with Milton Friedman and T.W. Schultz, and then Jacob Marschak. At what point did you have to consider a dissertation topic, and what was most interesting to you at the time? What were you thinking about doing?

01-01:25:55

Harberger:

I don't remember [laughter] which topic, which were the discarded topics [laughter], so to speak.

01-01:26:03

Burnett:

[laughter] Okay. Fair enough.

01-01:26:05

Harberger:

But in international trade, there was a big debate going on within the profession concerning elasticities of demand for imports. And arising out of certain models of international trade, it turned out that you had a stable, i.e., good, equilibrium, when these elasticities were sufficiently big; however, you could get an unstable situation if those elasticities were sufficiently small. And there were people at that time, important economists who were on the side of the small elasticities, and hence the idea of digging into this issue was an interesting challenge, so to speak.

And so the focus of my dissertation was on the elasticity of demand for imports of the United States, and I was trying to make better measurements of that elasticity by some very, very, tedious, and absurdly complicated, empirical work. The problem was that when people had tried to measure such an elasticity, they had worked almost exclusively at the aggregate level. And I tried to get down to the sub-aggregate level. So I had to look into the detailed import statistics of the United States, which are quite accurate and good, but

enormously detailed. And as I was pursuing data over a period of years, you would have certain categories, and these categories would change. So we would have cod, haddock, hake, pollock, and cusk [laughter] —

01-01:28:38

Burnett: [laughter] For the different kinds of fish.

01-01:28:38

Harberger: — in one category, but then some of the year it would only be cod, haddock, and hake, and I would have to find pollock and cusk somewhere else to put them in —

01-01:28:48

Burnett: Oh, my goodness.

01-01:28:48

Harberger: — or else exclude them from that.

01-01:28:51

Burnett: Maddening.

01-01:28:51

Harberger: It was maddening. And furthermore, I was involved in literally hundreds of multiple regressions. And these multiple regressions were done on a Friden calculating machine, where you punched in each individual observation. You had to multiply the Xs and Ys, and get the sum of XY, and the sum of XZ, and so on many, many times for everything. So it was an enormously labor-intensive and boring. I mean you got absolutely nothing out of the exercise of doing it, except perhaps raising the limit of your patience [laughter].

01-01:29:39

Burnett: Right [laughter]. Almost a —

01-01:29:41

Harberger: My yoga discipline [laughter].

01-01:29:48

Burnett: —a meditative aspect of — yeah, yeah, drawing pictures in the gravel, or something. So it was — and you felt it wasn't performing any useful work intellectually? Like, you couldn't —

01-01:30:02

Harberger: You mean what, to do that part of it?

01-01:30:03

Burnett: Yeah.

01-01:30:23

Harberger: No, that part of it was nothing. But I mean there were other parts of the thesis that were more interesting and challenging. And one chapter got published before I finished. It got published before my degree was granted. My degree

— I left Chicago in '49, in summer of '49, and started teaching at Hopkins, and I had to still do some work on my thesis at that juncture. But the degree was granted in June of '50, and an article from the thesis was published in the *JPE* [*Journal of Political Economy*] in February of '50. So some months ahead of my actual degree, and that paper was a — one of a — three or four most important papers that people recognize with my name.

01-01:31:14

Burnett:

And that was “Currency, Depreciation, Income and the Balance of Trade?”

01-01:31:16

Harberger:

And the balance of trade, correct.

01-01:31:19

Burnett:

And you were developing different models to show the effect of currency depreciation in a kind of Keynesian international order?

01-01:31:23

Harberger:

Well, it was basically setting this issue in a more complete model setup than had been used previously. And in doing so, I was able to cover Keynesian or neo-Keynesian cases, as well as neoclassical cases and to sort of display the panorama of results.

One of the most interesting aspects of that paper was its recognition that the balance of trade represented, if it was a deficit in trade, represented an excess of expenditures over production in a country, and a surplus would be an excess of production over expenditures. And that is simply an accounting identity, but it hadn't found its way into this range of issues before that. And Sidney Alexander, who later became my boss at the International Monetary Fund, wrote an article on the income-expenditure approach to analysis of trade deficits, and he told me that he got the idea for doing that paper from the way I was treating income and expenditure in my models. So it was interesting from that point of view.

01-01:33:31

Burnett:

So you were having an immediate impact. It sounds like right away that people were noticing this work, and were responding to it, and developing from it?

01-01:33:40

Harberger:

Well, that's what I said. The paper was very well received. That's for sure.

01-01:33:46

Burnett:

And there are policy implications [Harberger makes a negative sound] presumably? No?

01-00:33:48

Harberger:

I wouldn't.

01-01:33:50

Burnett: Or am I stretching it too much?

01-01:33:51

Harberger: I would not say — I mean I do believe that this thing that Sidney picked up on, that understanding that you can have a deficit in trade because the prices are wrong and where you need to devalue in order to correct these unrealistic prices. But you can also have a deficit because you're goddamn going into debt and spending too much [laughter], you see?

01-01:34:22

Burnett: Right [laughter].

01-01:34:24

Harberger: And to mention that. And then there's sort of a third interesting twist on this thing, that it sounds terrible when you're going into debt, but you can also say you have a deficit because people love your country so much, they're pouring money in to invest in your country. That also produces a deficit. So deficits aren't in any sense always bad, or always even a problem [laughter].

01-01:34:53

Burnett: Right. You have to be very careful about how you parse these things.

01-01:34:56

Harberger: Right, and anyway the topic was fun.

01-01:34:59

Burnett: And it sounds like you did this—and going back to your earlier narrative about doing things alone, you were part of a conversation it seems, right? In terms of the Chicago economics department, whom did you bounce ideas off? Who were your — was it everybody or?

01-01:34:26

Harberger: It was, let's say my thesis committee was Lloyd Metzler, who was a great international trade economist but who ended up with a brain tumor that cut short his productivity and his career. And Kenneth Arrow and Franco Modigliani, both of whom later won Nobel Prizes. And Metzler surely would have won a Nobel Prize had his health been maintained, had he not suffered this brain tumor.

So I had a tremendous committee, but I mean, remember, there were 200 students in the department. And I remember I would have an appointment with my chairman, Lloyd Metzler maybe once a month, or every six weeks, or something like that. And I would sit in an outer office, maybe for an hour and a half, two hours, two and a half hours because there were four people ahead of me [laughter] on that list. So there wasn't that much, and neither Arrow nor Modigliani were really trade people, Modigliani more so than Arrow, but they were valuable as a checks on the internal consistency, logic, methodology, empirical work, and all of that. But in terms of them being into this topic, the answer was not really.

01-01:37:04

Burnett:

And so it was more like you were preparing your work, and sending it out to them. And then they would evaluate it, and criticize it. Well, I was wondering about other conversations that you were having either with—in the process of taking a graduate courses, or with graduate students that had an influence on the kind of questions you were interested in asking as part of your dissertation, or your thinking about future work, or was this an all-consuming thing where you need to get this dissertation done, and it was the primary focus?

01-01:37:42

Harberger:

Well, I think it was more the latter than anything else. Remember that I was less than two years in the department altogether.

01-01:37:54

Burnett:

Yes, [laughter] it's astonishing.

01-01:37:55

Harberger:

The — what they call prelims [Preliminary Exams], what UCLA would call comps— I had passed them in the summer of 1948, and then started my thesis in the fall of 1948, and was out of there before the fall of '49 [laughter].

01-01:38:17

Burnett:

Well, can you talk a little bit perhaps then about, I mean you've already talked about using a machine, a mechanical calculator to do this kind of work and preparation. Could you break down for at the time, and perhaps this might be instructive to people today, thinking about if an economist graduate student today were to do the calculations for that dissertation —

01-01:38:43

Harberger:

Very interesting question. I know where you're going.

01-01:38:45

Burnett:

[laughter] — how long would that take for example?

01-01:38:48

Harberger:

No, I mean, it's just the opposite. The thing is that, faced with this daunting and terribly boring task of going through these kinds of calculations, even if you have somebody else doing you have to pay them to do it, you have to wait for them to do it, bang, bang, bang, and as a consequence we thought through our regressions to the last detail. Precisely how do you define this variable? Precisely what is the meaning and interpretation and all of that? We knew what we were after before we ever did anything, because we wanted to limit the amount of dog work that we had to do.

Today, graduate students do 50 regressions in an hour. And that leads them not to think seriously about the definitions of variables and the this, and the that, and the structuring of the model. You do it with this structure, you do it with that structure, you do it with the other structure, and that in turns leads to situations in which people try 50 things and they find the best one. And there

is always the question that will come with a two percent probability level by chance alone, so to speak. One in 50 [laughter].

01-01:40:22

Burnett: Right [laughter].

01-01:40:24

Harberger: They have to worry very much about this issue of surveying a whole horizon and picking something that works out particularly on their question. When we measure the statistical significance of that proposition, it is not — “that’s the statistical significance, etc.” — it never *thinks* about that process of experimentation; it thinks about the 50 different realities being done, you see, and [laughter] it is a serious actual trap, and certainly potential trap for everybody in modern times, just the fact that you can do tremendously complex calculations by just pressing a button.

01-01:41:23

Burnett: And there’s a certain loss of, I don’t know what the phrase would be, something like intellectual intimacy, or mathematical intimacy, in a sense that you’re working with the equations prior to —

01-01:41:35

Harberger: Exactly.

01-01:41:35

Burnett: — actually running it?

01-01:41:36

Harberger: Exactly. That you have thought through implications and so on, whereas when you have this easy experimentation at your disposal, you’re tempted to just use that in order to bypass much of that thinking. But nobody says you shouldn’t do that thinking anyway.

01-01:41:58

Burnett: That’s right [laughter]. So, maybe this is a way to start to talk about what’s unique about a kind of Chicago approach at that time, in the late 1940s. I think you reviewed an article called the “Pitfalls in Mathematical Model Building” —

01-01:42:28

Harberger: Yeah.

01-01:42:28

Burnett: — in 1952. We may be getting a bit ahead of ourselves, but it was a review of Dr. G. Stuvell’s —

01-01:42:37

Harberger: Stuvell, yeah.

01-01:42:40

Burnett:

Stuvel. “The Exchange Stability Problem,” and you argue that [Stuvel’s argument is] “Useful in that econometrician’s paradise where the numerical values of all the coefficients are known.” And so the contrasting case, the kind of work that you were doing by contrast, is that there’s this world of infinite complexity, right, and what you need to do is build a kind of robust model that explains *some* of what’s going on. Can you talk about —

01-01:43:22

Harberger:

I think this is a good point for us to get into my definition of the Chicago school.

01-01:43:27

Burnett:

Okay. Let’s do that [laughter].

01-01:43:28

Harberger:

Because it has very much —

01-01:43:31

Burnett:

Elements of that?

01-01:43:31

Harberger:

— very much that flavor.

01-01:43:31

Burnett:

Okay.

01-01:43:34

Harberger:

Many people think that the Chicago School is an ideological school of free market, so-called “neo-liberalism,” that type of thing, you’ll find in the press all through the years. Neo-liberalism doesn’t come in until maybe the 80s or something like that, but certainly the identification of the Chicago School with Milton Friedman in particular, and with free-market economics absolutely. And the thing is that if you define a Chicago School that way you will get Friedman, you may get George Stigler, you’ll get the probably three or four others over the period of time that I’ve been involved. But you’re not getting everybody. And yet, I think there is a Chicago School that does encompass everybody. And what are its premises?

First, that the world is incredibly complicated and we absolutely need theory. We just can’t get around with simple description and so on because the complexities of the world are going to overwhelm us. You need theory in order to organize and structure facts and forces so that you can begin to make some inferences, some suggestions about policy and so on. So we absolutely need theory.

My Harberger codicil to that, which I’m afraid not everybody really understands, is that when you thus impose a simple structure on a super-complicated world, you are necessarily over-simplifying. You’re not just simplifying; you’re over-simplifying. And the question is, which over-

simplification comes closest to capturing the reality of a thing? A thing, maybe at all times, or a thing here but not here, you see? There are these kinds of complications, but the emphasis that you need theory, and I would say that theory simplifies and over-simplifies is proposition number one.

Proposition number two of the Chicago School is that a theory is worth paying attention to to the degree that it helps us understand the world, maybe even predict the world, maybe to be able to use the theory in the formulation of policy, and make it useful in that sense. Usefulness in relation to the real world is a proposition number two.

Proposition number three is, when in doubt, assume that markets work. Not that markets are infinitely perfect and playing beautiful music all the time and never hurting anybody, and all of that, no. Market forces are forces that I liken to the wind and the tides. They are there. We poor mortals can't do much to change them. We can't order them to do things. But we can use them. We can recognize their existence, and learn to live with that existence, and make that living with their existence something that is to our benefit. So that's the third principle of Chicago school.

And by that principle nearly everybody at Chicago fits. Certainly, T. W. Schultz with D. Gale Johnson, Gregg Lewis, and so on. But I think even The Cowles Commission people— they were more formal, and we're going to come in the end to talking about formalism versus less formalism.

01-01:48:09

Burnett: [laughter].

01-01:48:09

Harberger: But even they are very much interested in confronting theory with data and learning from that confrontation about the real world. So that's my idea of a Chicago School.

01-01:48:27

Burnett: This is something that's apparent to you at the time, or is this something that emerges [later] in your global definition, in the wake of everything that's been said and written about the Chicago School, this ends up being the set of propositions that —

01-00:00:23

Harberger: Well —

01-01:48:49

Burnett: — capture the most?

01-01:48:51

Harberger: That is correct. But it's also true that I'm saying this was in the atmosphere at Chicago. Nobody was articulating it this way. The other articulation of these

principles was something that [James] Heckman did when we crossed paths on this subject and found that we basically come to the same vision —

01-01:49:18

Burnett: [laughter] Right.

01-01:49:18

Harberger: — of what —

01-01:49:18

Burnett: And this wasn't too long ago?

01-01:49:19

Harberger: Yeah, not too long ago, right, of the Chicago School. I, just this last year or so and I finally found a place where I had it, and I mailed it to him maybe six months ago or something like that [laughter].

01-01:49:39

Burnett: [laughter] Well, so as you said, there were a number of things going on. There was an incredible time for economics in general. There was just such a demand for — there are all these real-world problems. And there was this incredible theoretical ferment going on along all kinds of different axes, and there's a couple of things happening at Chicago, and one of them is this kind of applied theoretical approach like Theodore Schultz's approach or D. Gale —

01-01:50:15

Harberger: Right.

01-01:50:17

Burnett: — Johnson, and then there's the Cowles Commission work, and this is at a time when the Cowles Commission is at Chicago, and it's two floors up?

01-01:50:27

Harberger: No, it was on the fourth floor, along with most other economics offices.

01-01:50:28

Burnett: It was on the fourth floor, okay. So it shares a geographical space with the Chicago School of —

01-01:50:34

Harberger: Well, it was a part of the department.

01-01:50:36

Burnett: Yeah, can you talk a bit about it, and what it did at the time, and how it played into —

01-01:50:43

Harberger: Yes, well, let me begin, since we were on my thesis. I don't know exactly how it came about but I was invited, after I had started my thesis, to be a so-called

research assistant at the Cowles Commission, but I wasn't assisting anybody. All I was paid to do was to write my thesis.

So anyway, somebody had filtered some information to others, Koopmans and others, that I received this invitation. My guess is that Modigliani and Arrow were both Cowles Commission people, and they were on my committee. I think it was probably one or both of them that promoted this.

But anyway, we had a big office and we had maybe five desks in this office and Carl Christ occupied one, Jean Bronfenbrenner another, Steve Allen another, Stanley Reiter was downstairs. I shared an office with him for a little time, but we were all graduate students. We were all writing theses financed by the Cowles Commission, and the same room was turned into the seminar room by addition of folding chairs. Whenever we had seminars, and we had wonderful, wonderful seminars — when we had Arrow, and Modigliani, and Leo Hurwicz. Leo Hurwicz was also a great economist who ended up at Minnesota, also a Nobel Prize. And the three of them, Hurwicz, Modigliani and Arrow were all utterly irrepressible! And there had to be a rule and the rule was you could only interrupt for clarifying questions.

01-01:52:34

Burnett: [laughter]

01-01:52:36

Harberger: It rings in my head to this day, Leo Hurwicz had a very gravelly voice, and in a European accent he says, "May I ask a clarifying question [laughter]?"

01-01:52:47

Burnett: [laughter]

01-01:52:48

Harberger: And then he'd go on —

01-01:52:50

Burnett: Right, whether it was clarifying or not [laughter].

01-01:52:50

Harberger: — whether it was a question or not or whether it was clarifying or not. Then he would be interrupted by Modigliani who could never be stopped. Arrow, when he talked, talked so fast that people couldn't follow [laughter].

01-01:53:03

Burnett: [laughter]

01-01:53:04

Harberger: [laughter] It was just great, but these were great minds and a wonderful experience.

01-01:53:12

Burnett: And those would be discussing papers that people —

01-01:53:16

Harberger:

They would be discussing work of somebody, usually a member of the same coterie. I mean either one of us younger people or one of the people at the level of Modigliani, Arrow, Hurwicz, or Koopmans, Marschak, who were the reigning deities of [laughter] the thing. But it was certainly a tremendous group, and I find it hard to imagine any place where there was another grouping of equivalent size that had so much power in it.

01-01:54:04

Burnett:

Right. Just intellectual energy in the room. Did this provide you with a stimulating energy, I guess, as you were producing your thesis?

01-01:54:19

Harberger:

I can tell you, it's very interesting. Koopmans [laughter] comes into the picture at two ends. When I was first working he referred me to an article in an Italian journal. I think it was *Giornale degli Economisti*, but I'm not sure. But "models of international trade" was the name of the article. And I derived from that model of international trade thing the inspiration for that article that got into the *Journal of Political Economy*, and so on, and helped my career a great deal. So there was Koopmans at the very beginning as an inspiration, indirect, but an inspiration.

Then I'm doing my work, and I'm in front of this group in this room with folding chairs and all of that. And I'm presenting my equations. And I'm estimating import demand, for maybe a hundred different categories of imports. And in this process you have endogenous and exogenous variables, and I was treating the movements of income in the United States as being things that help determine imports, or particular imports, but are not reverse-determined by them. And Koopmans had written an article, which was called the "Shoelace" article, in which he was saying, and mathematically it's correct, that if the shifts in demand for shoelaces mirror exactly the aggregate shifts, that is just as much an endogenous variable through that correlation as if it were dealing with the whole of national income, not just the demand for shoelaces but total consumption, for example. That is mathematically true but it depends on the variations in shoelace demand being very much linked to these other things.

So I couldn't, within the framework, it wouldn't be workable to try to do this thing trying to make the determination of US GDP a part of my little model's problem. It's just impossible. But Koopmans had this idea of the shoelace argument and he didn't like the idea that I was treating income as an exogenous variable. And he made me write down what we call the Jacobian of the equations that I was using and the idea is that if a variable is truly exogenous, that its relevant number in the Jacobian is going to be zero.

01-01:58:21

Harberger:

And so he said, "Write down the Jacobian." He said, "Is this number zero or non-zero?" And I said, "It is *small*." [laughter] And I think you can see there a

big difference between the highly mathematical way of thinking where zero and non-zero are deeply meaningful, and a T. W. Schultz/ D. Gale Johnson/ Al Harberger/ Harry Johnson approach, who knows? How could you possibly say this is zero [laughter], you know? And I did some work later on to show that when it is small, there is a bias, but the bias is small.

01-01:59:20

Burnett: That's right.

01-01:59:21

Harberger: You see.

01-01:59:22

Burnett: I wanted to ask about that because in your papers, I'm hearing these criticisms as I'm reading through the paper that you are — you have your basic argument and then there are these caveats: "In this case..." and "one might object that this is" [laughter] — and then you defend —

01-01:59:50

Harberger: I try to do deal with them, yeah.

01-01:59:51

Burnett: And you deal with them or you accept that we may not know this and so it's this careful delimitation of the argument. You're not — you have to be very careful about the claims and in a sense modest, right, so that it's bounded, so that you can say that we are as confident as we can reasonably be about X —

01-02:00:16

Harberger: Right.

01-02:00:16

Burnett: — because we have done all kinds of, basically, games, to see what would happen if this were really true, and we would game it this way and in a process carve out what the argument is in its essence.

01-02:00:31

Harberger: Yeah, absolutely. No, the idea of, you know, we need simplification, but it's always over-simplification, and when it's oversimplification, it's never going to be perfect. That and yet, we have to do it. I often cite the cases of people who are making the national income accounts for example. When you make the national income accounts you have a whole set of boxes that you have to fill and there are some of these boxes where you have data down to a last penny and you're accurate and you know that and then you have data down to the last dollar and the last hundred and the last five thousand to the last ten billion. And the trouble is when you're making the national accounts you have to fill them all [laughter]. You don't have the option of just filling the ones that are nice and easy to fill and where you're going to have great confidence and the other ones, no. You just have to do that. So those of us who struggle with certain real-world problems get to have this as part of our blood, so to speak. In contrast, the quest for hundred-percent rigor and logic is a part of

mathematics and there you get accurate answers, and it *is* zero or not zero, you see what I mean?

01-02:02:13

Burnett:

Right. Absolutely. And it sounds like with all the increase in processing power today we haven't escaped that original problem of defining an argument that is manageable even if you had all the computing power in the world.

01-02:02:33

Harberger:

Oh, absolutely.

01-02:02:33

Burnett:

It doesn't get you out of that problem.

01-02:02:34

Harberger:

It certainly does not. No. No way.

01-02:02:38

Burnett:

Do you think that there's a technological over-optimism today or are people well aware of this?

01-02:02:45

Harberger:

I think the profession has become a lot wiser and more jaded over the years. We had a spate around the 70s of large-scale models with 200 equations and 200 unknowns. The Brookings Model, the Wharton EFU [Econometric Forecasting Unit] model, some model with the Federal Reserve, and these were all large-equation models, and you put in everything.

Well, the first thing you see when you have such a model is it doesn't even distinguish between the corporate and the personal income tax, probably, I mean, let alone, when we make a reform of the income tax, should we change rates, change the size of brackets, change exemptions, all of that? Even the biggest, most complicated macro-models can't possibly deal with that level.

And so anyway people worked with these 200 x 200 models for maybe a decade or so, and they found first of all that when it gave them an answer they could not specify really, couldn't explain to a politician why that was the answer. "Well, you see here's my model you see, and here are all the equations, and this is what it tells me, and therefore you should do this or that," so to speak. No politician ever responds to that kind of thing, see. You have to be able to convince them so they could have a rationale in their heads as to why they're doing something. So there is that problem.

But also there's the issue that when you have so many equations the chains of causation are far too complicated for the human mind to understand. So you have to treat your model as a black box and believe it. And since it gives you clearly not accurate answers a lot of the time [laughter] this whole way of doing things fell into disuse and after that decade.

And nowadays, I think most people realize that it's — I liken it this way, that I have problems with my knees, and I go to an orthopedist to deal with these problems. Now the orthopedist is supposed to know that I have some problems with my heart, that I have a pacemaker, that I take blood thinners, that series of things that are important outside of the knee. But they're a limited number of things, and he needs a limited amount of information about them whereas with respect to the knee, he wants all the information and wants every little detail, x-rays to see the little chips that are there.

So that's the way I think we are in economics when we're dealing with a specific problem of let's say agricultural policy or something like that. We focus on the agricultural sector and we may want to break it down into the wheat belt and the corn belt and the cotton belt even to deal with these problems, and yet in the background we take into account macroeconomic things like monetary policy, exchange rates and so on, but at a much lower level of precision.

01-02:06:40

Burnett:

That sounded like Ted Schultz's genius when it came to — so many agricultural economists were focusing on the farm as a unit of production. It was like this microcosm of inputs and outputs, and he was looking at the entire world, right? How are these markets interacting, what were these different policies doing?

01-02:07:03

Harberger:

Of course.

01-02:07:03

Burnett:

— and how did that feed all the way down to the individual farm problem? And that sounded to me like that's the kind of Chicago approach that's been under-represented —

01-02:07:11

Harberger:

Very much so. Very much so.

01-02:07:12

Burnett:

— in the literature.

01-02:07:16

Burnett:

And even talking about Friedman's "as if paper" in 1953, against this excessive obsession with verisimilitude, that your model is going to mirror reality, and instead arguing that we can simplify this and if it makes robust and accurate predictions, then it may not matter necessarily what's inside the black box as you said. It does, but for the purposes of his argument he's a pragmatist in that sense, right?

01-02:07:58

Harberger:

Well, I think he pressed this Karl Popper stuff too far and not many people want to go along with it, and I think T. W. was always thinking "what are

those farmers thinking? What are they responding to?” And so on. And there somewhere in these conversations we’ll get to talk about the Austrian school but Chicago is different from the Austrian school by a considerable amount, but one of the things that I like about the Austrian school is that they are willing to use introspection as a source of information. “How would I behave in the situation?” is not a dumb question. [laughter]

01-02:08:53

Burnett:

[laughter] That is very true. People are — is it that people would be reluctant to do so because it’s considered to be unscientific to —

01-02:09:07

Harberger:

Reluctant to?

01-02:09:08

Burnett:

To use introspection, to talk about your own ... to empathize?

01-02:09:11

Harberger:

Well, I mean it isn’t the “I.” It’s what would normal people do, you see? It’s *that* that introspection gives you. From your observation of humanity and your own personal experience, how do people respond? And we know that most of the time people respond rationally, people respond in their own interests and so on. So we build that in, but there certainly are situations where people, where their behavior is not well predicted by the standard economic assumption, I mean that the famous story that, if you’re working for an employer and you’re supposed to contribute to your retirement plan do you sign a thing that says — “normally, we will deduct five percent of your salary and put it into your your retirement account but if you check this box we will not do this and we will give you that five percent separately and you will not contribute to your retirement account.” Okay, you get about ten percent of the people that check the box. You turn it around the other way, ten percent of the [laughter] people check *that* box. So it isn’t 10 and 90 so to speak, it’s whatever that guy is saying is that you don’t have to do anything [laughter]. That’s the option that people accept. Well, I look into myself and say “my goodness isn’t that true [laughter]?”

01-02:11:19

Burnett:

[laughter] That’s a very different kind of rationality in making these kinds of choices. I don’t know if I cut you off there when you wanted to talk about the different things that fed in when you were at Cowles and the different things that fed into your thesis research. What were the things that more broadly influenced your thinking that you took away from working at Cowles during that period?

01-02:11:52

Harberger:

Well, I mean, this is another Chicago element that we talked about a little earlier, that those people wanted to talk about important things. And that the idea that to be able to assemble the group of quite powerful minds that try to deal with important things and not just get publications. It’s a tremendous

stamp that is put upon the person who experiences that aura. And I think it helps in later career.

01-02:12:48

Burnett:

Oh, absolutely. Absolutely. One of things you wrote about when you were talking specifically I think about Ted Schultz and D. Gale Johnson, although there might have been others as well, you described them as “champions of diagnostics.”

01-02:13:06

Harberger:

Yes.

01-02:13:07

Burnett:

That is your phrase. “They viewed the economy as a dynamic organism.” Can we back up from that to the contrasting case? So, you must have been disappointed with people who were not [laughter] “champions of diagnostics?” In other words, is there something about the field that was looking at static states and elaborate models that didn’t take into consideration—?

01-02:13:35

Harberger:

Well, this is a complaint that many of us have about the trends in recent teaching in economics in graduate schools and so on. People learn all sort of complicated modeling rules and things like that, but send them to a foreign country and have them look at agriculture or industry or foreign trade and say “well, what’s wrong here and what can be done to help?” T. W. and D. Gale could run rings around them! And part of that was they had natural abilities of this kind. But it’s also true that training in their time and in my time, when I was being trained, whatever capacities a person had were being honed and sharpened by the training. But the training that you get today most of the time is far too heavily mathematical and —

01-02:14:41

Burnett:

Formalist?

01-02:14:41

Harberger:

— formalist, yeah.

01-02:14:44

Burnett:

Yeah, I wonder to what extent, and this is something that I was thinking about in my own research, to what extent [this Chicago approach] derives from what agricultural economics was like in Ted Schultz’s and D. Gale Johnson’s day. When they were servants of the state [at Iowa State University] they had to serve the farmers, they had to serve the public. And the government would ask them, “how do we deal with this problem?” Farm groups would ask them “how do we deal with this problem?” They constantly were having to help people. And they got into all kinds of trouble.

01-02:15:17

Harberger:

Well, I would say that Schultz in particular and Gale was young at that time when he was at Iowa State with Schultz before he came to Chicago, but I think Gale, certainly later, neither of them have much truck with those who thought of agricultural economics as farm management somehow. It isn't that they felt that farm management was unimportant, but it was something that well, it's almost always different everywhere, different crops, different rotations, all of that. And you need experiment stations and they loved experiment stations and they should do things and there should be extension to extend the results of the experiment stations to the individual farmer. Gale and Ted would agree with all of that. But they would say "where do the tools of economics come into this? I'm an economist, I'm not a farm manager," so to speak. And then they go with simple things like supply and demand and international prices that are determined in a world market and see the farmer as being sort of a pawn [laughter] of those forces that are there. And of course, T.W., not only when he started, but I would say for maybe half, maybe all his career, there were always important voices in the political world with economists being there on their side to be cited, so to speak, that said we must protect the family farm, you see. And protecting the family farm meant fighting against the tide instead of going with the tide. And T. W. was 100 percent, 150 percent [laughter] for going with the tide, harnessing that tide, making it something that turned out to be worthwhile for the participants in the process and all of that. That was their way of doing things and D. Gale in his later years was going all around the world. He went to Russia. He went many, many times to China, had an important role in the liberalization of agriculture in China.

01-02:18:17

Burnett:

Yeah, it sounds like we're speaking of "they're champions of diagnostics," but they also viewed the economy as a dynamic organism. And I think what you're speaking to is very true that in the farm sector there was this need — there was a movement to fix the standard of living for the farmer and to base it on —

01-02:18:49

Harberger:

To parity.

01-02:18:50

Burnett:

— on the price. Yeah, the parity price ratio.

01-02:18:53

Harberger:

That's it, yeah.

01-02:18:54

Burnett:

And Shultz famously said prices are and now I'm blanking [laughter] on what his —

01-02:19:06

Harberger:

Prices are endogenous.

01-02:19:07

Burnett: Yeah.

01-02:19:08

Harberger: They are set by the economic process. And what had happened in that interim there was enormous technical advance in the production of agricultural commodities. And the use of parity prices was again fighting the tide as determined by these improvements in technology differing widely from one commodity to another commodity.

01-02:19:40

Burnett: Yeah, he basically said that prices are not goals; they're signals.

01-02:19:44

Harberger: Right. Right. Exactly.

01-02:19:45

Burnett: And they were misreading what these things can do for people.

01-02:19:50

Harberger: Yeah, and well, if you say they're signals you have to allow them to signal and you don't want to fix them. [laughter]

01-02:19:57

Burnett: Right, they don't do their job. Yeah. So that's I think kind of a spirit of — what I meant by service is not necessarily to individual farm management but to using what they knew, their tools and Schultz was an expert in international trade. He also got his dissertation in international trade. And so he understood that the goal of this economist at a state university was to provide service using those tools and that meant how to act as a broker between these different groups who don't agree completely on the way the world works, right [laughter]. So he had to connect them up somehow with a rationale that could appeal to these multiple constituencies.

01-02:20:48

Harberger: Well, I think there's another pitch that I often make and that is that we economists have a certain responsibility to society to bring to society's attention what our science has enabled us to learn and how it can be helpful and so on. And that is our job. And in order to perform this job we need a seat at the table. And when we're sitting at that table we have to give priority to the things that we can say speaking as professionals and not treat equally our individual political preferences about this, that, or the other thing where all the guys around the table are just on a par with us. They should not be treated at parity with the things that only we know and they don't [laughter].

01-02:21:54

Burnett: Right [laughter].

01-02:21:56
Harberger: We have to try to convince them of the things that our science tells us they should know, and that was T. W.

01-02:22:06
Burnett: Right. Do you think that, I mean at that time there was a number of kind of Chicago, I think the Committee for Economic Development was in Chicago at the time?

01-02:22:19
Harberger: No. No, CED was meeting in —

01-02:22:22
Harberger: — New York.

01-02:22:23
Burnett: New York mostly?

01-02:22:23
Harberger: Most of the time when I went there.

01-02:22:24
Burnett: Okay. It did get started in Chicago though, I think?

01-02:22:29
Harberger: That I don't remember.

01-02:22:29
Burnett: Yeah. In '43. And the idea at that time, so this is just to speak to the larger zeitgeist, was to bring — it was led by the business community, but they wanted enlightened individuals from all the sectors of the economy to sit down at the table and work things out.

01-02:22:50
Harberger: Think through real problems.

01-02:22:50
Burnett: Yeah.

01-02:22:52
Harberger: Wonderful organization.

01-02:22:54
Burnett: And is that — and there were others too like the National Planning Association—so is that something that was in the air in terms of the spirit of economics of what it could do in intersecting with these communities?

01-02:23:06
Harberger: Well, I certainly you see, first of all, the whole society was significantly impacted by the Great Depression, and I think aware of the idea that economic policy could do both good and ill, and that it would be smart for people to really worry about how you can make best or near-best actions in different

areas of economic policy. And the Committee for Economic Development consisted mainly of high executives of Fortune 100 companies [laughter].

01-02:23:51

Burnett: That's right [laughter].

01-02:23:53

Harberger: Very large companies and I worked with the CED I don't know for 10, 12, 15 years. I don't know. And it was incredible to me how, in some sense, selfless they were. They were not parochial, each one trying to defend his or her little range of interest, but thinking broadly about the whole society. And they dealt with all kinds of problems: foreign trade, taxation, education —

01-02:24:29

Burnett: Agriculture.

01-02:24:29

Harberger: — agriculture. Exactly. And I think I give them way better than B+.

01-02:24:41

Burnett: [laughter] You give them a grade?

01-02:24:44

Harberger: —to their average report, because they were really quite serious and wise and they consulted good people and they did hard work and they paid quite a lot of money on research in given areas.

01-02:25:03

Burnett: And quite a University of Chicago connection. So there was: you consulted for them, George Shultz consulted for them, Milton Friedman consulted for them, and Ted Schultz was —

01-02:25:15

Harberger: T. W.

01-02:25:15

Burnett: — head of their agricultural committee I think for longer than he was head of the department of economics—

01-02:25:23

Harberger: Agriculture, yeah. Yeah.

01-02:25:23

Burnett: [laughter] So, and D. Gale Johnson too I think was involved. And there may be others that I don't know about. But there's a real participation in that kind of — it's a form of policy—it's kind of a think tank before its time, I guess. Would you be comfortable calling it a think tank—

01-02:25:52

Harberger: I would.

01-02:25:53

Burnett: Yeah. It's before the days of think tanks.

01-02:25:55

Harberger: I would certainly and I think that I have high respect for Brookings [Brookings Institution] and AEI [American Enterprise Institute] and Hoover and I think that within the range of what it was doing, it wasn't a permanent organization with permanent staff doing all these things but it's certainly the intellectual level of its output I'd say is comparable to these other three.

01-02:26:22

Burnett: So you complete your dissertation in 1949 and, I think that year I think this is before you get your position at Hopkins or —

01-02:26:46

Harberger: I get my position at Hopkins in the fall of '49.

01-02:26:56

Burnett: Okay.

01-02:26:56

Harberger: I still had my thesis to be finished, but whatever had to be done was done on top of my duties. And that was done and approved, and I got my degree in June of '50.

01-02:27:22

Harberger: I was teaching before I got my PhD.

01-02:27:24

Burnett: Okay. And so there — in here as well, you're also invited to the International Monetary Fund. Is that —

01-02:27:36

Harberger: That is true.

01-02:27:37

Burnett: Okay.

01-02:27:37

Harberger: At Johns Hopkins they had a small department and the year that I joined in '49 they had J. J. Polak from Washington, who was head of the research department of the IMF [International Monetary Fund]. And he came on Monday nights and taught a three-hour lecture. And I sat in on that whole course, and at the end Polak invited me to be a summer person in the research department at the Fund. And so I went in the summer of '50 to the Fund and I worked in a room with T. C. Liu and S. C. Tsiang. They are well recognized as the architects of the Taiwan Miracle. They were both Chinese in origin and they helped Taiwan. I don't know exactly what the timing of their thing was. They both ended up as professors in Cornell. And I think that the — it would have been difficult for them as functionaries of the research department of the Fund to be doing as much as they did with respect to Taiwan. So I think most

of that work was done when they were at Cornell, but it was truly a miracle, I mean, their international trade multiplied by 10! Things like that [laughter]. So they were two, and Michel Verhulst was a Frenchman who was in that same room, and another Chinese named C.G. Chang and our boss was Sidney Alexander, whom I had mentioned earlier, who later who later became a professor at MIT [Massachusetts Institute of Technology]. I worked that summer studying the devaluations of 1949 and had a piece in the, I think, August 1950 issue of *International Financial Statistics*, two or three pages, but those were big pages with charts and data and all of that tracing the differential effects of the series of devaluations that had taken place in the world in 1949 stimulated by the great British devaluation of the pound from \$4 and something to \$2.80.

01-02:30:28

Burnett:

And what was it like working at the IMF [International Monetary Fund] at that time? This is a different experience for you and it's a real connection to policy work?

01-02:30:51

Harberger:

Well, the thing that I did for the Fund was more empirical than policy-oriented at the time. But obviously the effectiveness of these devaluations [laughter] had ramifications for policy, I mean my piece was about policy decisions in the first place, and how effective were they became a matter of considerable interest.

01-02:31:32

Burnett:

So let's talk about the Hopkins years a little bit. Well, I guess maybe we're getting a little bit ahead of ourselves but —

01-02:31:48

Harberger:

That's okay. We —

01-02:31:51

Burnett:

We've talked a little bit about the *American Economic Review* "Pitfalls in Mathematical Model Building" in which you contrast — you talk almost with a great respect about the econometricians paradise where the numerical values and all the co-efficients are known. And so you're making a case for your kind of economic analysis.

01-02:32:26

Harberger:

Exactly.

01-02:32:27

Burnett:

So can you talk about, during the Hopkins years, that environment, that milieu, how it was different from Chicago, and were you just on your own research trajectory at this point? You were animated by the questions that you had from your own research?

01-02:32:48
Harberger

Well, I think the story's very clear that I was there that first year. I was working on my thesis and attending this seminar of J. J. Polak. That summer I went to the IMF [International Monetary Fund] and did this work and that was published in its own way in *IFS* [*International Financial Statistics*]. And then the next summer Sidney Alexander calls me and says, "Would you like to join the staff of the Paley Commission?" And the Paley Commission was the president's materials policy commission which had been named by Harry Truman to study the markets for materials. Now what had been the trigger for all that was that when the Korean War broke out in the summer of 1950 the prices of major materials, mainly minerals but many other materials too, they just skyrocketed. Some of them multiplied by three or four. Many of them doubled. And many people including President Truman were worried that if just something like that Korean conflict can trigger such a response what about our overall economic growth in the future? What will that do to the prices of materials? Are materials going to be a huge bottleneck to the economic growth to the US and the world economy? And all of that. So this is what prompted Truman to name this Materials Policy Commission of what Bill Paley, who was president of CBS [Columbia Broadcasting System] at that time, I guess he was the founder of CBS. He was the chairman and that's why it's called the Paley Commission, Ed Mason who was a leading figure at Harvard—who later became dean at Harvard—he was a key economic member, and the fella who wrote *Mr. Blandings Builds His Dream House* was also [laughter] on that commission.

01-02:35:33
Burnett:

That's a very broad commission [laughter].

01-02:35:35
Harberger:

[laughter] So anyway, my job there was to make projections of the demand for all sorts of specific materials—of antimony, bismuth, bauxite, cobalt, chromium [laughter], you name it, up to zinc [laughter] at the end, for 25 years into the future. And not only for the US but for the world economy. And I did this basically by myself. I didn't have any research assistants or anything like that and I was very lucky that I somehow was able to persuade, first Sidney Alexander and then the next level and then the next level, to please put my name on this document because I had devoted a good year of my life to that, and didn't want it to be buried in some anonymous form. So that happened. So who reads my chapter but T.W. [Schultz]? And T.W. reads this chapter "Projecting Materials Demand from 1950 to 1975," and he says, "This is our man for public finance in Chicago."

Now you try to figure the logical connection [laughter] between A and B. I certainly, after all these years, I cannot do it, though I understand why. You see, most econometricians would have fitted equations and extrapolated them for 25 years. They would have gotten terribly wrong answers with that for all sorts of reasons. The main ones being, I mean you look at — if you're making equations you have to work with the past. What is the past? It's the Great

Depression and the war and the immediate recovery to the 1950s. [makes dismissive utterance] So my approach was to build a picture of what the US economy as a whole would look like in 1975. How many people, how many households, how much demand, how much real income, how much demand for housing— how many houses do people want but then how much construction each year do we need, what will be the normal construction in 1975? Same thing for automobiles, appliances, and other things. And I had this whole pattern of major variables and then I tended to link the demand for specific materials to specific end uses of those materials and those end uses were linked to what's going to be happening to the demand for refrigerators, automobiles, housing, this, that, and the other thing. Well, knowing T.W., he sees this, he says "this is real-world economics!" See what I mean? He sees what he wants to see [laughter].

01-02:39:22

Burnett: Well, or you were partly a product of —

01-02:39:31

Harberger: Of course.

01-02:39:31

Burnett: — the Chicago way of thinking, that you see the world as a dynamic set of forces and that you need to game that dynamism in making any kind of prediction.

01-02:39:45

Harberger: Yeah, whatever. Anyway that —

01-02:39:48

Burnett: [laughter]

01-02:39:50

Harberger: — leap from, you see, I go to Hopkins. I happened to be there when Polak teaches. Then I go to the [International Monetary] Fund. Sidney Alexander is leading. Sidney Alexander takes me to the Paley Commission. I write this thing in the Paley Commission. Schultz reads this. I get an offer from Chicago [laughter] to go to Chicago, I mean it's crazy! My degree was in international trade. And I was teaching international trade at Hopkins; I was not teaching public finance. I was given the field of public finance. Here, take it. Do with it what you will. Incredible! And I had a non-tenure appointment. And —

01-02:40:42

Burnett: Non-tenure appointment at Chicago?

01-02:40:43

Harberger: At Chicago. And I got tenure— I don't remember whether it was in '59 or before —no, I think I was actually promoted to full professor in '59. But anyway, I had an offer from Northwestern or was it Minnesota? I forget whether it was — I had for both places, but I forget which was the trigger. Anyway, I had this offer and this was going to be at like \$12,000 a year. And I

presented the letter to T. W., who was the chairman, and he took it seriously and a day or two or three later he called me back and said well, we're ready to match the conditions of this offer and promote you to full professor. The offer was for full professor. My instantaneous response, which Schultz would delight in quoting all the way to when he died was, "I'll take the money, but not the rank." And the reason was that if I was a recently promoted full professor at Chicago, what was going to happen to my market? Nobody's going to want to dip into that for another decade. So I said this salary is too low for me to be thus encumbered, so to speak, and I said I'll take the money and I'll stay as an associate professor and by God the offers kept pouring in and when I finally became full professor, [laughter] I had something like \$20,000 instead of— [laughter].

01-02:42:54

Burnett: That was a smart move.

01-02:42:56

Harberger: And but Schultz *loved* it. You see. It wasn't just that he —

01-02:43:04

Burnett: He delighted in the economic rationality of it?

01-02:43:06

Harberger: Exactly.

01-02:43:12

Burnett: [laughter] Well, that's great. So we are getting a bit ahead of ourselves. At the President's Materials Policy Commission [Paley Commission], you developed a different model from the way the econometricians would have done it.

01-02:43:35

Harberger: Yes.

01-02:43:35

Burnett: It's something that came in handy, I mean you work it into papers down the road—

01-02:43:44

Harberger: No, if you want a denouement from that— what was the absolutely key thing and this may also have impressed Schultz— the best year that we had for a jumping-off point for 1975 was 1950. I was able to absolutely declare on a stack of bibles that 1950 was a *vastly* abnormal and unusual year in that the demand for durable goods of all kinds, plus housing was catching up from not having them during the Depression, and then not having them during the war.

So we were just *piling* these demands on. And I was able to project sensibly, that it would be decades before we repeated the levels achieved in 1950. And I was right. It would be decades. And that experience led me, when I got to Chicago and we started the research group or workshop in public finance, that the first publication that came out of that was the *Demand for Durable Goods*.

And there we had Dick Muth doing housing, and Meyer Burstein doing refrigerators, and Gregory Chow doing automobiles, and so on. And that was a very interesting thing, and was simple economics, but it was not swallowed so to speak by even most economists at that time, that you have to think of the demand not for how many cars are going to be demanded this year. First of all, you say, what about car ownership? How many people are going to want to own cars? And then what is going to be the rate of depreciation of this stock of cars? And what is going to be the rate of growth of that demand? And the depreciation plus the growth is the normal demand for the flow of new cars. And yet, at certain times you can far, far fall short or overshoot that normal demand and where we were in 1950, and in all the durables cases, we were way overshot.

01-02:46:33

Burnett:

Right. So it kind of long cycle of demand around when you're talking about durable goods.

01-02:00:16

Harberger:

Well, yeah. Well, I wouldn't say long cycle just because a cycle implies that there's a kind of automatic internal dynamism. This was just a *fact*.

01-01:59:51

Burnett:

Okay [laughter].

01-02:00:16

Harberger:

[laughter] That we had had this Depression and we had had this war and here we were in a prosperous economy and guess what? A lot of demand for housing, a lot of demand for cars and all of that had a corresponding impact on demand for materials.

01-02:47:05

Burnett:

You wrote up later in '58 I think, based in part on this research on materials, the total stock of materials, right, what's going to happen to that, and one of the things you concluded is that it's a bit of a moving target, even if you were to calculate the total stock of copper or example. A), you're going to find more. B), you're going to substitute copper for some other kind of goods—

01-02:47:39

Harberger:

Yeah. Well, all of that was part of the basic argument. In terms of copper in particular, when we were projecting the demand for copper we recognized that copper was being replaced by aluminum in electrical transmission. So, we didn't put any copper in 1975 into the transmission, but we put aluminum there and this was because we had this prior knowledge of this technological change that was actually visible already but if you measured what was happening now it was only partial substitution and we're going to have a more complete substitution by later on. And we tried in collapsible tubes and foil, we used a lot of tin for toothpaste and things like that. We put that into plastics later you see. We used whatever little information we had to modify what would have been a mechanical kind of projection.

And the other thing that I would say I like a lot about that work is that I told it just like it is. That is, I tried to bring the reader into the utter uncertainty that we're facing. It isn't "oh, here we have the answer" and all of that.

01-02:49:22

Harberger:

"*This* is what we face. *This* is our choice as to what to do. *This* is why we're making *this* choice instead of *that* on the basis of *this* evidence," you see. And that kind of thing I really try to advise students all the time: don't try to hide your uncertainty. Put it right out there in front and bring your listeners or readers into your problem, rather than pontificate and tell them "here, this is the way it is because my equation tells you so."

01-02:50:02

Burnett:

There have been critiques of neoclassical economics, arguing that, compared with back in the old days with older forms of economic rationality, [in which] they would think about the total stock of things—this comes into some of the climate, environmental-change debates and so on— they used to consider the total stock of things but now we only consider things on the margin, so we're blind to the future. Based on what you've just told me about this kind of research for the Paley Commission it sounds like there *is* uncertainty, but you are very much exploring, you can be exploring these kinds of concerns about the total stock of supplies of things. When you were thinking about and researching about technological substitution, the way in which demand stimulates increased supplies, do you have a different view of, say, when the Club of Rome published its studies in '72 about these, just a —

01-02:51:15

Harberger:

They were always wrong!

01-02:51:16

Burnett:

— a series of graphs —

01-02:51:17

Harberger:

[laughter]

01-02:51:17

Burnett:

Yeah, can you talk about that? I mean this is this — it's a doomsday book about how we're running out of natural resources —

01-02:51:24

Harberger:

Well, this brings us to the big fat message of the seven-volume report of the Paley Commission. It was "relax kids, don't worry" — that we have enough coal to last us for centuries, and we — with oil, what is the problem with oil is that the people worry that we only have 10 years of supply of oil. And the reason for that is that once you find a well, you better start drilling it. And it lasts about 10 years. So as the process of exploration goes on, we keep finding more, and there was knowledge about known reserves, but known reserves keep increasing as you can see with what's happened in recent years. We keep finding more and more ways of doing that. And needless to say, now that we

have atomic or nuclear power the issue of will there be enough energy is not even there. There will be enough energy and it's just, what are our preferences as to how and what potential risks do we run when we do A and B and C?

01-02:52:55

Burnett:

And it sounds to me like a lot of the, and this goes back to your characterization of T. W. Schultz, and D. Gale Johnson, and Friedman's work—this attention to lags, I mean that's what the economists—I was talking about this with George Shultz as well, that a key service of the economist is to communicate with the public about expectations for how long things take or [laughter] how one can reasonably expect —

01-02:53:28

Harberger:

Well, I mean I think I like to emphasize Milton's emphasis on lags in juxtaposition to some of the rational-expectations people's way of modeling things, you see. A famous rational expectations story is Ricardian equivalence, and that's a statement that, it doesn't matter whether a government finances a given piece of expenditure by going further into debt or by putting new taxes because people will react the same. They will know that the added debt implies taxes in the future, and they will react right now to the fact that those future taxes are there, so it doesn't matter which of these two it is. Well, many empirical studies have shown that's absolutely crazy that — and the people will react when they see it *coming*, so to speak, when they see a new tax on the books that's going to hit *them*. And if it's in being debated in the congress maybe they'll react that early, but they're not going to react 20 years in advance, or 10 years in advance [laughter] just because the government went into debt. They might be dead when the government is paying that debt so why should they react that way?

So, in any case, when the rational-expectations people say that well, something new happens, a new piece of information comes, many rational expectations models say, "well, now that we know this is going to happen, yesterday the price of copper was \$2, but now it's going to be \$3.50 because there's going to be this extra demand for copper from this thing, and right now. So the price of copper is going to go up to its new equilibrium right away.

Well, it doesn't happen like that. The uncertainty, the information doesn't filter. Some people know; other people don't know. People who do know act, some people don't act right away. All these reasons put all sorts of incredible amounts of lags in there and those lags are not easily predictable. We don't have — it doesn't say that every time a new piece of information about copper price comes out people are going to react the same way. It's a different piece of information, it's coming from a different part. It's more plausible, less plausible, goodness knows what. So you're going to have uncertainty about the length of lag and the speed of adjustment and so on.

Well, Milton has this with respect to people's speed with which they move from an old level of real monetary balances that they want to a new equilibrium level. Will they go in one week, will they go in a month? One time they'll go in a month, another time they'll go in a year. It isn't asserting irrationality on people's part; it's trying to represent complicated human behavior in some coefficient and one little coefficient isn't always going to be right, and it isn't always going to be the same. So Milton in that sense showed less chutzpah [laughter] let's say than some of the rational expectations people who want, for the neatness of their models and the implication of a postulative rationality, you see, to jump to responses that turn out to be quite unrealistic.

01-02:57:58

Burnett: You've been hired now at the University of Chicago, and your job title is professor of public finance.

01-02:58:14

Harberger: No, my title is Associate Professor of economics. [laughter]

01-02:58:21

Harberger: Yes, but my job is public finance, right.

01-02:58:24

Burnett: Right. The job that you've been given. And so how were you going to approach your research — did you — how did you think about that when you started—

01-02:58:42

Harberger: Well I mean this was the thing, that let's say for some courses, I had one course on taxation on the tax side of public finance, one course on expenditure on the expenditure side of public finance, and then I taught price theory basically all the time. I don't think it ever stopped all 38 years, except when I was on leave when I would fail to teach —

01-02:59:20

Burnett: Price theory was your domain for —

01-02:59:27

Harberger: Well, I mean I taught that— for the first graduate course in price theory, 301, we gave it twice a year and Friedman taught one and I taught one for a long time. Then Friedman shifted over to teaching monetary courses, and didn't teach price theory anymore. And then other people would teach 301. And I — we tried to maintain a sort of Chicago style and tradition for price theory which is for real. And our price theory was different from Harvard, or MIT, or Stanford, or Berkeley price theory and so on. But you hire somebody from a place and they're going to give the damn price theory course that they had. So what do you do? So our response to that was, that person, these new people who are going to teach price theory, would teach price theory jointly with me one time and then they would be able to do it on their own. And then they would have in their head at least two [laughter] different recent in-depth

experiences. It wasn't that they ran through Harberger's notes and so on; they were actually doing some of the teaching, were present at all the lectures, doing all that stuff. And so we had Stanley Fisher and Dennis Carlton, and Gilbert Ghez, and Bob Topel; at least those four did this joint teaching of 101 before they themselves moved into teaching it themselves and that helped to maintain some of the Chicago flavor in the 301 course. And it was interesting because we had people, senior people later on who deeply wanted to teach that course, but would have done it in a very different fashion [laughter], and between Chairman Schultz and Chairman D. Gale Johnson and Chairman Al Harberger [laughter], they never got to do it [laughter].

01-03:02:10

Burnett:

[laughter] Well, the way the historians tell it is that the teaching of price theory, in most other economics departments— In most *academic* departments, the core course is shoved down to the most junior faculty as a chore, that you have to teach this course. In Chicago, it was the reverse; you wanted the most — those who are most acculturated at the very least and perhaps the most senior and accomplished Chicagoans teaching price theory. How do you react to that description of —

01-03:02:52

Harberger:

Inaccurate.

01-03:02:54

Burnett:

Yeah?

01-03:02:55

Harberger:

It's just that we had these new people coming in and taking over. Remember, we had two 301s, two 302s every year. So we had these changes of guard taking place and certainly it's always true that, let's say, of the four price theory courses at least one or two any year were actually taught by very senior people. There's no doubt about that. But that's probably true that at least one was always taught by somebody who isn't that [laughter]. And sometimes, two or three would be taught by people who were not that senior.

01-03:03:42

Burnett:

But you did have an acculturation mechanism —

01-03:03:45

Harberger:

But we definitely — we were very conscious that Chicago price theory had a character of its own which we wanted to try to preserve, that for sure.

01-03:03:58

Burnett:

How was it done differently at other universities broadly speaking? How was it —

01-03:04:08

Harberger:

More math.

01-03:04:09

Burnett: Okay.

01-03:04:09

Harberger: That's the main thing and less — less diagnostics, more math.

01-03:04:16

Burnett: And so at Chicago, price theory is more —

01-03:04:17

Harberger: More diagnostics, less math.

01-03:04:19

Burnett: Okay.

01-03:04:21

Harberger: More link to the real world in easily observable form, so to speak, and trying to give people a sense of touch, a sense of smell about things.

01-03:04:38

Burnett: And the — and Stigler's *Theory of Price* was a key text or?

01-03:04:43

Harberger: It was a text, as was Friedman's *Notes on Lectures in Price Theory*. That was an interesting thing. I took that course before he — those notes were taken by Dave Fand around 1951. And I took the course I think '47 or '48. When I took it, it was one of the most brilliant expository achievements that I have ever seen. I mean Friedman was there just driving this stuff into your head, and mostly without notes or anything like that, just highly organized and very didactic. He said that once these notes were taken, he didn't do that anymore. It was sort of a little bit like "any questions on page 37?" [laughter], "any questions on page 38?" It was more trying to fill in what people were supposed to have read in these lectures. And that was the way he ran his workshop too that for the workshop on money everybody was supposed to read the paper before the workshop. And so people would sit down and Friedman, "Any questions on page one?" [laughter]

01-03:06:30

Burnett: [laughter] It sounds like the flipped classroom before it's time. This is like a new pedagogical thing that people are talking about and here he was doing this way back when. So you've returned and you're teaching these courses in taxation and expenditures and obviously the job description of public finance is going to shape your research?

01-03:07:06

Harberger: Yes, and it did, and Schultz I don't think made a mistake in figuring that I would do a job in public finance. And I was very happy with the workshop. That workshop was just incredible. We had Zvi Griliches who became president of the American Economic Association and a member of the National Academy of Sciences. We had Gregory Chow whose, actually, the

Chow Test is something that emerged from his dissertation in our workshop. We had Richard Muth, we had Lester Telser. We had Mark Nerlove who had been my student in Hopkins.

01-03:07:58

Burnett:

Oh, really?

01-03:07:58

Harberger:

He came back to stay with his parents and write his Hopkins dissertation, but he wrote his Hopkins dissertation in my public finance workshop on agricultural supply [laughter], and won the John Bates Clark award for it [laughter]. Griliches also won the John Bates Clark award so there were two of them in the workshop at one time. Later Lucas was in my workshop. And I always tried to wonder how I was able, being so young and fresh so to speak, was able to get such good people, and I just have the instinct that people had more scope in my workshop than in the others, that they were less intimidated by me than they would be by Friedman or if even Schultz. And they had wide ranges of topics and I was ready to accept them. Walter Oi did his dissertation on labor, the — what was it called? *Labor as a Quasi-Fixed Factor of Production*. He was in that workshop at the same time. These were all — at least six people who later made big names for themselves in my one workshop in the 50s. And I not yet having tenure [laughter]. It's kind of crazy.

But now I'm going to tell you a secret of our workshop. People call a workshop anything these days. But a seminar is something where people present formalized papers and are very often invited guests from the outside. A workshop can be having formalized papers but only mainly people from the inside. Our thing was different in that the workshop was closed to outsiders. It was only us. And everybody was expected to take his turn in presenting his material. And the rule was you had 15 or maybe 20 minutes to tell us about your successes since the last time you reported. The whole rest of the time is to be spent worrying about the problems you have encountered. So everybody shared in struggling with the problems of each and every dissertation in that thing. And my favorite, favorite moments of that workshop are times when we had 20 minutes of absolute silence while people were just thinking about some crazy problem that Gregory Chow just posed for us and nobody was finding [laughter] an answer. But you can see it's a very different atmosphere from that of an ordinary seminar. It's just totally different. And I think people gained a great deal from it because you really got to *know* six, seven other people's problems in depth and to feel them as problems.

01-03:11:47

Burnett:

And the structure was that you would follow it through the entire year that you would be —

01-03:11:53

Harberger:

Well, we would just take turns.

- 01-03:11:55
Burnett: And you just rotate?
- 01-03:11:56
Harberger: Just rotate, yeah.
- 01-03:11:57
Burnett: And so every six weeks or so you'd have to say: this is the progress I've made
—
- 01-03:12:02
Harberger: Exactly.
- 01-03:12:04
Burnett: — but I've discovered something new that I'm stuck on." I'm wondering if you could help me with this. And it just — then they descend on the problem together.
- 01-03:12:11
Harberger: Exactly.
- 01-03:12:13
Burnett: And there's that benefit of improving each other's work, right? So it's perhaps no coincidence that all six end up being really important works because it's kind of a collective product in the end, to some degree, to some degree.
- 01-03:12:28
Harberger: Well, I think it's more that the authors did the most learning but the others absorbed things that would be helpful for them in their future work.
- 01-03:12:48
Burnett: Right, because it's problem-solving training at the same time, right?
- 01-03:12:51
Harberger: Exactly.
- 01-03:12:54
Burnett: They're thinking about how to apply this to new problems in the future.
- 01-03:12:56
Harberger: Yeah.
- 01-03:12:59
Burnett: Well, there's a tremendous amount going on at this time too because — then we're going to talk about the workshop system I guess next time. And one of the reports is there's a kind of changing of the guard in the mid-1950s where there's a number of senior folks who've retired and left. Some few years before like John Nef and Paul Douglas have left a long time ago.
- 01-03:13:35
Harberger: John Nef, well, I mean I guess he was still around when I was there.

01-03:13:35

Burnett: He was? Okay.

01-03:13:37

Harberger: But I'm not certain as to when he departed from the scene, but go ahead.

01-03:13:44

Burnett: There's a memo from, I think 1956, where Schultz is talking about there's the departure of Cowles for example, a number of senior folks had retired.

01-03:13:57

Harberger: Exactly. Okay. Okay.

01-03:13:58

Burnett: And there was a sense of having to build up and you're part of that, building up the program to something new. You are both — you're both a student in an earlier period.

01-03:14:10

Harberger: In the 40s, yeah.

01-03:14:12

Burnett: In the 40s and you're one of the new hires. Are there any contrasting — is there any contrasting shift in what Chicago was like in the mid-50s as opposed to the 40s? That's a tough question I know [laughter].

01-03:14:33

Harberger: No, I think it's [laughter] — it's pretty tough. I think the big event there was the departure of Cowles. I don't know if you want to talk about that now, but that's fine if we do.

01-03:14:51

Burnett: Yeah, I would like to know about that and —

01-03:14:55

Harberger: That is an interesting thing in several ways. First of all I was a member of the Cowles Commission both when I came back on the faculty and when I was only a graduate student. But I was the only one of the Cowles faculty that didn't move when Cowles moved. And the interesting thing when I returned was that Koopmans and Roy Radner who was a very well-known econometrician organized a weekly hour with me in which I was supposed to explain to them what intuitive economics was all about[laughter].

01-03:15:54

Burnett: Okay [laughter].

01-03:15:55

Harberger: And so we would meet and we would talk about different kinds of problems and I would be trying to communicate some of the things that we have talked about here, the differences in the angle at which you look at reality and how you appreciate reality —

01-03:16:13

Burnett: Problem choice.

01-03:16:14

Harberger: — and all of that. And it was always of interest to me that they sensed there was something they might possibly learn from this, that they were not dogmatic. But I think the other thing is that Koopmans's mindset was the opposite of intuitive. It was, he wanted order and rigidity in just the way he thought and so it was very hard for him. If there was some uncertainty involved, he wanted to know the probability distribution [laughter]. And if he didn't [indicating Koopmans's disquiet], that was no good.

01-03:17:09

Burnett: [laughter] Wow. I had never thought that — so they knew that there might be some kind of difference or perhaps deficit in the way they approached things. So there was something that they could add?

01-03:17:21

Harberger: Well, I don't know. I would not try to characterize it that way. You simply can't have everybody thinking all the same way.

01-03:17:29

Burnett: Right. Sure.

01-03:17:31

Harberger: Let's put it this way. There are people who can have differences and look upon each other with considerable respect not only personally but also intellectually. And there are many people who look at each other each with great disrespect. Do you understand?

01-03:17:56

Burnett: Yeah.

01-03:17:57

Harberger: And little understanding that that guy has a row to hoe, so to speak.

01-03:18:05

Burnett: Right. Right. Absolutely.

01-03:18:08

Harberger: And this experience that I report indicated that the Koopmans and Radner were aware that it was another furrow there that might be interesting to know something about. And I always appreciated that with them.

01-03:18:22

Burnett: Yeah. But in the end perhaps it's too far afield from the way they understood things and the way they understood their approaches—

01-03:18:29

Harberger: Oh, they weren't going to become — they didn't want to become T. W. Schultz I mean [laughter].

01-03:18:33

Burnett: Right. Right. [laughter] But it's —

01-03:18:37

Harberger: Nor was Schultz going to become Tjalling Koopmans.

01-03:18:39

Burnett: Right.

01-03:18:41

Harberger: Each is an utterly absurd thought.

01-03:18:43

Burnett: Right, the cultures were that strikingly different.

01-03:18:46

Harberger: They were very different, correct. And the story of the move of the Cowles Commission is also I think somewhat interesting. Koopmans had been the head of the Cowles Commission for a term or maybe two terms, I don't know. But he was finishing a term and he wanted to emphasize he didn't want that job again. So he took a year's leave at Yale. So he gets to Yale and it turns out that the Alfred Cowles is an alumnus of Yale, and that several other members of the Cowles family are alumni of Yale and the Cowles Commission has moved once from Colorado to Chicago. And who knows how it all evolved but I think you can see here that the tinder and the lighted match are pretty close to each other. And it — I don't think it was something that came out of huge animosities at Chicago; I think there was more this semi-positive element within the Cowles arrangement, and I would say another thing that the Cowles Commission became the Cowles Foundation and there is no question that in its fewer years at Chicago the Cowles Commission produced much greater impact on economic science than has the Cowles Foundation in all the years since it's moved. Now I don't think that it would have been easy at all for it to happen at Chicago. I'm not saying that. It's not a fair comparison. But it is just worth noting that the glory years of Cowles are the years at Chicago.

01-03:21:02

Burnett: I guess historians will have to pore over why that was the case.[laughter]

1-03:21:10

Harberger: Well, I mean there are things in science that are always things waiting to be discovered. And so simultaneous-equations estimation, instrumental variables, all this stuff was invented in those few years say '46 to '50 at Chicago, and with a great bunch of people.

01-03:21:46

Burnett: Well, culture matters as well and place matters in the development of these very complex and important ideas. Well, perhaps we'll stop for now and we'll take up next day.

[End of Interview]

Interview #2 September 22, 2015

Begin Audio File 2 harberger_arnold_02_09-22-15_stereo.mp3

Session 2A, Morning

02-00:00:00

Burnett: This is Paul Burnett interviewing Dr. Arnold Harberger for the Economist Life Stories Project of the Oral History Center at the University of California, Berkeley, in conjunction with the Becker Friedman Institute. And this is our second full-day session, September 22, 2015. So Dr. Harberger, last we left off was your return to the University of Chicago. This time as an associate professor.

02-00:00:43

Burnett: And we talked a little bit about the teaching there. And I was wondering if we could start to talk about how your position was to focus on public finance. And I was wondering if you could talk a little bit about the “Monopoly” paper you produced in 1954 as a way to start talking about the nature of welfare economics.

02-00:01:13

Harberger: Yeah. Well, I don’t really remember how I came to be invited to speak on this particular topic at those 1954 meetings or ’53 December meetings, I guess which ended up being published in 1954. But in any case, since the price theory that I learned from Friedman had an overtone that well, the world is not perfectly competitive certainly, and it’s not perfect in any way, but how bad are the deviations from this? And you learn in the study of price theory that monopoly causes the price to be higher than marginal cost by a monopoly markup. And this monopoly markup I emphasize—not many people do—actually is really a privately imposed tax. And how big is that tax then comes the question. And a 10 percent tax on the value of the product is a hell of a lot. And it—can we think that people are putting 50 percent taxes or 80 percent taxes on our products? That’s crazy to think that. Oh, there would be huge, huge profits floating around in the economy, and the earnings of businesses would probably be three or four times what we actually observe.

So this was all in my head early on. And when it came to writing this thing about monopoly, I was very lucky to discover this study of manufacturing in the 1920s that had a lot of data on profitability of different sectors of the economy. And so what I said was, “How are we going to figure out what is monopoly profit?” Well, suppose we just look at the distribution of all of these profits and say, “Well, the average is the norm, and everything that is above norm is due to monopoly.” [laughter]

02-00:04:23

Burnett: Just [laughter] for the sake of argument.

02-00:04:26

Harberger:

Bang! And then measure the triangles that come from this, and this brings us again to triangle economics. The triangle basically is this, that when you have competition, what the buyer pays is what the seller receives. So the benefit to the buyer is matched to the cost to the seller. But if you have a tax then the buyer's paying more than what the seller gets. And the social benefit is bigger than the social cost. And that represents a distortion. By eliminating that tax you gain this triangle, which was there from Dupuit in 1842, and was elaborated on by Marshall in the 1890s, and by others after that. But in the modern era, people call it the Harberger Triangle [laughter].

02-00:05:39

Burnett:

[laughter]

02-00:05:40

Harberger:

But you see I was reviving that in a general equilibrium context and doing some measurement of it. And that aspect of it, really, the measurement is mine [laughter].

02-00:05:55

Burnett:

Right [laughter].

02-00:05:56

Harberger:

So in any case in this "Monopoly" paper, I made some simple assumptions about, not the demand faced by each individual firm, but let's consider the auto industry. The auto industry might have an elasticity of demand of two, okay. If that industry had constant costs and was exercising the full monopoly power corresponding to an elasticity of two, it would have prices double costs, twice costs. And that excess would be on top of costs that would already include the normal return to capital. So you'd have the normal return to capital being, let's say a third of costs, and then you'd have three more times that return as the markup.

Well, that's not what we observe. Why? Because Ford Motor Company doesn't face the demand for automobiles; it faces the demand for *Fords* [laughter]. And the demand for *Fords* has to face the competition of Chevys, and Plymouths, and nowadays, Volkswagens, Toyotas, and all of that. And not only are the existing other producers in that picture, but there is potential competition, the invitation to entry. If you put your price too high, there's going to be entry by others. And in order to forestall that entry, you are being constrained. So the demand curve facing Ford is nothing like the demand curve of for all automobiles as a class.

And the elasticities that I used said well, we have all these auto producers and their having markups, but the demand for autos goes along the demand for automobiles. So within that framework, it's as if Ford was putting a seven percent tax and Chevy was putting a 10 percent tax, and so on. And I was measuring what were the effects of those overall taxes, where the substitution

that was going—fighting on between Ford, Chevy, Plymouth, Volkswagen, and so on was washed out, and kept this overall tax, instead of being double costs, to be maybe 10 percent more than costs.

And the end result of that story was that the efficiency cost due to monopoly was a very small percentage of the GDP [Gross Domestic Product], and something that was in a sense not a big, fat social problem. Not something where'd you expect, "oh, the government ought to be doing this and that and the other thing." The internal, call it monopolistic competition or whatever, that keeps these markups relatively low, was sufficient to have the efficiency cost of monopoly remain low.

Well, that paper made quite a splash, and it sort of kept my juices flowing [laughter] in this whole area of applied welfare economics. And I've worked in applied welfare economics in different ways all my life.

02-00:10:30

Burnett:

And I suppose the larger context is that in American law, monopoly is a problem, and it has legal—there's the Anti-Trust Act, there's all of these—and there's a public and popular perception of monopoly. And so this was an intellectual problem for you, but it did have all of these ripple effects I think for a larger discussion about the nature of monopoly.

02-00:11:02

Harberger:

Well, you can look at this another way, that when we measure GDP, probably capital gets out of GDP a third or maybe 30 percent, not more than a third, okay. But GDP included depreciation of capital. So if you go down to the income level, the typical measures have been, historically in the United States, capital gets a quarter of the national income. That *includes* monopoly profits [laughter]! And that monopoly profits aren't really properly a return to capital. You see that tax is a tax on the product of labor *and* of capital [laughter].

And so a piece of that is it doesn't really belong as part of the return to capital, even though it's classified as profits. So you can see how small the monopoly tax has to be almost just from the knowledge that on the income side capital only gets a quarter of the national income. How much can monopoly be responsible for, since we know we've got a capital stock four times GDP and has to be earning a reasonable rate of return?

02-00:12:37

Burnett:

Well, did that spur other Chicagoans to do, I think other Chicago folks were looking at, I think Friedman and others were looking at other institutions that may capture some monopoly profits?

02-00:12:59

Harberger:

There could be a labor monopoly, and so on. People did end up looking, I mean it was not due to my paper by any means, but we should recognize the fact that business monopoly is not the only monopoly in the game. And indeed

it is I think correct to say that the United Autoworkers lived for a long time on the great advantage that the United States had vis-à-vis other places in producing cars. So that they got wages that were well above what a competitive labor market would have produced. And that was passed on to consumers through higher prices of automobiles and did not get reflected in monopoly profits of the auto industry. They were captured by these firms and we had widespread labor monopoly issues for quite a time, and we probably still have it in some of the entertainment area, and some of the highly professionalized parts of the labor force, and so on. But labor monopoly has not been part of my game—what Harberger said about monopoly in the “Monopoly” paper had to do with industries [laughter].

02-00:14:55
Burnett:

Fair enough. But yeah, there was a kind of a Chicago approach to looking at other institutions, and at farmers’ co-ops for example, and that happens down the road. And, I guess there was the Free Market Study that Friedman and others were involved in, and that was ’46 to ’52, and they were looking at monopoly and the second iteration of that was looking at Anti-Trust law. So that get into a law and economics stuff, but it’s in the air in other words that your colleagues were doing analogous kinds of research in other domains.

And, it’s an interesting paper because you did this analysis to account for this concentration of profits over costs. And you conclude that, for this period in the twenties, it’s about \$60 million for the entire U.S. economy and that, adjusted for 1952 dollars comes out to \$1.50 for every citizen. That’s what’s being—that’s the monopoly [surplus] that’s being exacted.

And then you allow for other counter-arguments, and this is kind of your style. You anticipate criticism, so you adjust it. You say well, so at most this might be \$2.25 per person. So and you have this caveat. It doesn’t mean that there are no monopolies at all, nor that the amount of money is insignificant, but it’s far less than what one has been led to believe in the general public discourse about monopoly.

02-00:16:31
Harberger:

Exactly.

02-00:16:37
Burnett:

And so that’s an early foray I guess into some of the debates about welfare economics. Can you talk a little bit further about what you felt was— how welfare economics had evolved up until the time that you started looking at this stuff and what was wrong or what was going off track a little bit in your mind?

02-00:17:15
Harberger:

It’s hard for me to go back that far [laughter].

02-00:17:24
Burnett:

[laughter]

02-00:17:26

Harberger:

People were, I think, going too far about what we can't say. And looking at nuances of issues — I talk about this a lot in my 1971 paper. People were worried about the changes in the marginal utility of money, and all of that and casting doubts on the validity of measurements like mine. And what I point out is that everybody accepts national income and GDP and applied welfare economics is one full degree more subtle. We have a thing in mathematics called a Taylor Expansion. And the first order of that is the national income and the triangle stuff adds further subtlety to a second order. And what do you want? Do you want a third order out there? You see. And if everybody accepts national income, why have so many doubts about something that's more subtle?

02-00:19:35

Burnett:

Subtle, right.

02-00:19:37

Harberger:

Than national income. And this is basically my pitch.

02-00:19:40

Burnett:

Okay. So on the one hand you're showing that things are more complex in certain domains but on the other — I think one of your refrains is that there's a need—there needs to be a space for constructive economic work. In other words, that someone could potentially *do* something, [laughter] right—

02-00:20:06

Harberger:

Exactly.

02-00:20:07

Burnett:

—with the work that you're doing.

02-00:20:09

Harberger:

Well, I mean I think all the time about those guys in ministries and cabinet departments and agencies of government and so on and what they are doing. And I think we should, in our overall conversations, get to spend some time on the idea of economics as a profession. Profession that has what? Practitioners! So I'm always thinking about these damn practitioners [laughter] and what they do and what difficulties they face and so on. And some of the literature is way up in the stratosphere compared with the life of a practitioner. And isn't at all addressing the many problems, the many little holes that they have to fill with data for example as we were talking the other day. So I think that that difference in focus is part of what distinguishes some of my work from the stuff that I was either criticizing or at least deviating from.

02-00:21:43

Burnett:

Right. Right. And so you're a champion of applied economics.

02-00:21:49

Harberger:

And trying to help those poor guys [laughter].

- 02-00:21:50
Burnett: Right [laughter]. Did you, I mean you talked about yourself at the IMF [International Monetary Fund] as being a researcher and you were but did that exposure to that institution, is that the beginning of your thinking about this as you need it to have kind of policy-relevant stuff? Not stuff that's immediately applicable?
- 02-00:22:12
Harberger: Well, I mean that was there in my mind but it didn't come from being at the Fund that summer.
- 02-00:22:20
Burnett: Right.
- 02-00:22:22
Harberger: That's—
- 02-00:22:22
Burnett: There was quite a splash in response to the monopoly paper you said. Mostly positive or did it open up a whole range of—
- 02-00:22:35
Harberger: Yeah, I think was a big boost of my career. That's no question.
- 02-00:22:45
Burnett: And I—there's some other things that we want to start talking about as well. And I'm quite sure where to fit this in but there's the research group in public finance. Is that where you talking about—
- 02-00:23:08
Harberger: Well, we talked about that yesterday.
- 02-00:23:09
Burnett: That was your workshop.
- 02-00:23:11
Harberger: That was the workshop, yes.
- 02-00:23:12
Burnett: And then that results in the edited volume of papers?
- 02-00:23:16
Harberger: *Of Demand for Durable Goods*, yes.
- 02-00:23:19
Burnett: Right. So perhaps we can turn to talking a little bit about the next piece of your career that begins to unfold in the mid-1950s. Before we get into that there's just a small detail that I wanted to ask you about. There's a note in your long resume about a consultation you did for the US Department of Agriculture.

02-00:23:52

Harberger: I don't have any memory of that. Zero.

02-00:23:54

Burnett: [laughter]

02-00:23:58

Harberger: [laughter]

02-00:23:58

Burnett: I was going to use that as a segue into asking you about Schultz and D. Gale's work on domestic farm policy issues and connections that might have in the larger scope of what becomes development economics. Did you have conversations with D. Gale Johnson or Ted Schultz about "the farm problem" or the farm problems plural?

02-00:24:28

Harberger: Not, I would say not really. With Ted, I had close relations with Ted Schultz all the time as long as he was there. In his older years he used to invite Anita and me to breakfast at a Swedish restaurant on 57th Street and we would talk for a couple of hours there. And I talked with him in his office very often and he would give me papers of his to read and make suggestions and so on. So we had that kind of relationship and I would say my connection with his papers was somehow polishing. I was more in touch with the ongoing profession than he was. And when he would be saying something that these guys would not like or something like that, I would change the wording and so [laughter] it would—

02-00:25:48

Burnett: [laughter] It would fly a bit better?

02-00:25:48

Harberger: —go down better [laughter]. That kind of thing.

02-00:25:54

Burnett: Okay. Okay. And he was a real powerhouse, I mean there's one key memo in 1956 where he's laying out the funding that's coming into the department. This is kind of unusual, or maybe you can set me right on that. The number of foundations and the funding streams coming into the economics department in the mid-1950s is \$1.4 million for a department that has something like 11 or 12 standing faculty?

02-00:26:28

Harberger: No, it had 25.

02-00:28:29

Burnett: It had 25, okay. But still, it's an impressive number in 1956 dollars. And it's coming from all this variety of sources. Could you talk about research entrepreneurship at Chicago, as much as you could, as distinct from other programs that you knew about?

02-00:26:53

Harberger:

I can't. But what I can say is that T. W. Schultz had something of a magic touch. And I believe that this magic touch came from the total, total seriousness of the way he looked at economics, that when he was looking at agriculture and its problems it wasn't to advance his career, ever! There wasn't the slightest hint of that, you see. So he could go to Rockefeller and say, "There is this problem." And they would believe everything that he told them. Another guy would come and they'd say [looking askance] [laughter] "What is his true purpose here—"

02-00:27:46

Burnett:

Agenda.

02-00:27:48

Harberger:

—to advance himself in some way." Never, never in the case of T.W. And I think that was incredibly important. I don't know how the workshop system of course—agriculture workshop existed before anything. But the workshops at Chicago, the first outside financing was to Friedman's and mine and this was when I was just a whipper snapper coming in and Friedman was a demi-God already [laughter].

02-00:28:32

Burnett:

[laughter]

02-00:28:32

Harberger:

So I got in in a lucky way but I don't know where or who fostered that money but I know it wasn't me.

02-00:28:46

Burnett:

Okay, it was in place when you got to Chicago?

02-00:28:49

Harberger:

I think what happened was that there was an idea of—no, it was not in place. It was after I got there that it came, but I had no direct role in the raising of that money. So I'm guessing that I was represented by T. W. and Friedman was helped by T. W. or the other way around. Whoever went to the Rockefeller Foundation to get that money, I'm guessing it was T. W. And that he wanted to broaden the workshop system, and Friedman was very much in favor of that. And so probably T. W. just put public finance in there because of his visions, which, you know, he had these tremendous instincts. And I was the beneficiary.

02-00:20:03

Burnett:

And maybe you could talk a little bit about trust in economics. It seems to be, there's trust in terms of one's skill as an economist and that's internal I think to the discipline. People vet you as to your skill and ability to work with formulae and so on. And then there's another level of trust to other institutions and so on. And Schultz seemed to have that knack for staking his reputation on his claims and defending his reputation and really being seen as a reliable and trustworthy actor.

- 02-00:30:55
Harberger: Yeah, he was just a unique person. Was it North or South Dakota that he came from?
- 02-00:31:00
Burnett: South Dakota.
- 02-00:31:02
Harberger: The story goes, which you probably know, that most many people believe he could have been a senator from South Dakota and opted for the economics profession instead. And that's a very nice way to think about Schultz, because he had all of the statesman-like characters of a great senator, not just *a* senator but a *great* senator. And he didn't put them in the senate; he put them in the economics profession [laughter].
- 02-00:31:42
Burnett: [laughter] He was using the discipline to act in a statesman-like fashion.
- 02-00:31:49
Harberger: Absolutely.
- 02-00:31:50
Burnett: I'm wondering if that inspired you at all because you're also going into these—these are kind of political domains, right?
- 02-00:32:02
Harberger: I don't know, I mean the, whatever, helping society and all of that, I think that came out of my upbringing [laughter]. That was there.
- 02-00:32:19
Burnett: And the church.
- 02-00:32:24
Harberger: And that I certainly gravitated then to him, and why was Schultz one of my three great mentors? Well, that's why [laughter].
- 02-00:32:36
Burnett: Yeah, that sensibility appealed to you.
- 02-00:32:39
Harberger: That I had that very strong link to him, so to speak, and I think that went through all our years together.
- 02-00:32:50
Burnett: One of the things that's obviously a factor in the post-war era, in 1949 there's Truman's Point Four speech, right, about technical assistance being an important feature of American foreign policy. And this sets in train a number of initiatives, scholarly initiatives in a whole range of social sciences over the next several decades. Could you talk a little bit about how that begins to unfold at Chicago shortly after you get there?

02-00:33:34

Harberger: Say this again?

02-00:33:35

Burnett: Just the interest in technical assistance overseas, technical cooperation projects, and so I know that Schultz was involved—

02-00:33:47

Harberger: Well—

02-00:33:49

Burnett: —early on.

02-00:33:51

Harberger: T. W. was there and my feeling is as of that time, remember, we were only 25 at the time [laughter], or less. So it was mainly T. W. I'm not sure that D. Gale was yet involved in the overseas part of the story. But T. W. had been overseas from day zero. He went to Russia around 1930. And he was forever interested in agriculture in developing countries. So it was he that had this National Planning Association grant dealing with technical assistance to Latin America. We're getting into Chile now.

02-00:34:48

Burnett: Yeah, a little.

02-00:34:48

Harberger: And that grant enabled him to have minions in Mexico, in Brazil, in Argentina, in Chile, at least those, and what he did was every year he'd go a couple times around the horn [laughter], so to speak, and visit these branch operations of the NPA [National Planning Association] grant. So he got into Chile in '54 or '55, and there was a, what is now USAID [United States Agency for International Development] was then called ICA, International Cooperation Administration, and the director in Chile was Albion Patterson. And somehow Schultz had a dinner with Albion Patterson at which he expounded on problems that he saw in Chile, in other counties in Latin America, etc. And Albion Patterson found this so impressive. He said, "This is the kind of economics that this country, Chile, ought to have more of." And so without any knowledge of us, or by Schultz either, Patterson wrote to the two main universities in Chile and said what would you think of a contract of technical assistance with the University of Chicago economics department? And at the time the University of Chile was in the middle of a deanship fight and, so far as we know, that letter remained unopened on the desk of the dean [laughter].

02-00:37:00

Burnett: Oh, really? [laughter] That was it?

02-00:37:02

Harberger: While the one that came to the Catholic University was opened immediately and responded to immediately. And then we got an invitation to have such an

arrangement and the first thing that Schultz wanted was to go down there and see what things were like, what the lay of the land was. Did we want to do this or not? So a small group of four was T. W. Schultz, Earl Hamilton, who was knowledgeable in Spanish, he was an economic historian that worked a lot in Spain, and me, for my Spanish knowledge, and Si [Simon] Rottenberg, who also knew Spanish and was, I don't know exactly what his connection was at that time.

Anyway, the four of us went down and we stayed for about a week or 10 days in Santiago. We looked at the setup at the Catholic university and we were introduced to many people in the business community. We ate at the Union Club at the center of town and so on, and some lunches. And as a consequence we got into this contractual relationship. T. W. played an incredibly important part in that because when we visited the Catholic University there was not a single full-time professor [laughter]. Not one. And Schultz wrote into the contract that, by the end of our contractual relationship, the Catholic university was committing itself to have at least four of our people as full-time professors. Moreover, they were not allowed to require as a commitment in advance that oh, in return for your getting this scholarship in Chicago you have to come back here and be full time with us. There was no such enslavement involved. The university had to make the terms of the contract sufficiently attractive that these people would come. Well, I think that was the key. By the time this contract ended, we had a five-year contract and a three-year phase-out extension. So it went from '56 to '64. By '64 they had 13 full timers; now they have 40 full timers. In world-wide surveys of economics in Latin America, this department has been the top department for more than 10 years. And [laughter] it's to go from no full-times to the best in Latin America at a USAID [United States Agency for International Development] cost in the few —\$2, \$3 million probably.

02-00:40:35

Burnett:

Right. Can we back up to your—now is this your first trip overseas or not overseas, but first trip outside of the United States?

02-00:40:45

Harberger:

Outside of the country.

02-00:40:46

Burnett:

It is.

02-00:40:46

Harberger:

I went to the Econometric Society meetings in Montreal—in 1954.

02-00:40:54

Burnett:

Okay.

02-00:40:54

Harberger:

And my next trip was the '55 trip to Chile [laughter].

02-00:40:58

Burnett:

Okay [laughter]. So this—what kind of impressions did you have in your first visit to Chile?

02-00:41:09

Harberger:

Well, let me finish one thought.

02-00:41:12

Burnett:

Sure.

02-00:41:13

Harberger:

Well, I talked about T. W.'s insertion into the contract. My contribution to that was not in the contract, but was in the implementation of the contract in which we saw to it that approximately one third of the people who came to study in Chicago came not from the Catholic University but from its rival, the University of Chile. And that created a situation where when we were finished we had sown seeds into both of them. We also toned down a big rivalry kind of situation and made a much more cooperative and mutually respected situation in Chile. And when you look at Chile now, you've got to think, that, starting in the late fifties, early sixties, we have these seeds in both of the main universities where the future legislators, the future journalists, the future radio and television people all can study economics there leading to a situation where for many years in the democracy in Chile, you had four, three, four major parties and you could hardly see the differences in their economic platforms. And this seamless transition, from government to government, where—from right to left, there was a center-right government and then a center-left government [laughter]—the underlying policies were pretty much the same. I think this one of the keys to the great success of the Chilean economy in these subsequent years. And not only I, but you'll hear more about Ernesto Fontaine, who was a great economist and a great observer, he shares this opinion that the degree of consensus on economic policy that was found in Chile had part of its origin in our drawing of people from both universities rather than only one.

02-00:44:22

Burnett:

In the early TALA studies, which were kind of surveys to figure out what the scene was like in a number of different countries in Latin America, one of the things that Schultz and the other scholars who were writing these reports were noting was that, at least in the case of agricultural economics and agricultural sciences, the faculties of agriculture were disengaged from agricultural activity in these countries. And so you had a faculty of agriculture that had a kind of bookish, book-learning approach, but they weren't connected to the larger economy. Was there a kind of understanding that economics that was being done there, or the approach to economics was, as you have laid out for your identity as an economist, to be an economist who was engaged in the larger economy and engaged in larger issues?

02-00:45:32

Harberger:

Well, this project started in 1956. I was there for about three months at the very beginning of the project. And at that time one would say that there was a big ideological gap between the University of Chile, and the Catholic University, the state university having some professors who were very vocal and stridently left wing, and *dirigiste*-oriented, and the Catholic University being more free-market-oriented, even in those days. But certainly, Si Rottenberg who was our first representative there, was in my view too ready to engage in ideological debate, rather than in demonstration of the merits of good economics.

I should add when we're talking about that project that's another thing which I consider—we consider a mistake that T.W. made, in saying we would do no teaching in the Catholic University, that we would only do research and try to show by demonstration of this good research, that would happen. That was not a very successful aspect of the project. What happened there was that you couldn't get any of us, 25 full-time Chicago professors, to live in Chile for four years [laughter], and do this beautiful research down there in isolation from all of our colleagues.

So what we had was, I mean Si Rottenberg was director number one, and Jim Bray was director number two. Both of them respectable PhDs, people who had a few publications in the literature and so on, but were not top-drawer leading economists forging forward their field. And so the vision that the people that we were going to put down there would be such great examples was a little bit visionary, let's put it that way [laughter]. And when we later had a project in Argentina, we did do teaching in Argentina, having learned that particular lesson from Chile.

02-00:49:10

Burnett:

Getting back to first impressions, did you see that there was a kind of political division in the country between left and right? Was there kind of a sclerosis as the—

02-00:49:29

Harberger:

Well, I don't know in the country. What one could say is that the Chile that I went to in 1956 was a heritage that maybe began in the 1930s in Chile with a sort of popular front government at that time, which engaged in a policy of import substitution and so on. That was my big impression in going there. Protection of automobiles was such that my original car was a 1949 Ford and I think by the time I was in Chile it was worth about \$500 in the United States in the used car market. And in Chile, it was worth about five times that. And this was because of *policy*. When later we had the Kennedy administration, "New Frontiers," I don't know if you remember that slogan, and I don't think I ever published this piece, but I was spreading it around in speeches and calling it "New Frontiers for Old Cars."

02-00:51:34

Burnett: [laughter]

02-00:51:34

Harberger: And the idea was to buy these old cars in the United States, take them to Chile, sell them in the market and with the proceeds of that sale, what we were going to do? I think we were going to produce housing for poor people or something like that, and then you would rent these houses to the poor people, and with the rents you would subsidize the education of their children [laughter]. So you get about 15 bangs for the buck with just these used cars.

But all sorts of markets were totally protected. Imported cars would be selling for five times their price in the United States, and imported refrigerators for two and a half times the price and so on. Everything was that way. Then behind these huge barriers to imports you had the local production which was in small batches, was expensive and poor in quality. I wrote a thing, I don't know if you ever saw the "Memorandum on Chile?" My—

02-00:53:10

Burnett: When was that published?

02-00:53:11

Harberger: Well, it wasn't. It was published in Chile but not in the United States [laughter].

02-00:53:17

Burnett: No, I don't think I've seen that.

02-00:53:19

Harberger: But this was about a 20-page letter to my colleagues expressing my impressions of all the things that were kind of crazy in some sense of the economic organization in Chile at that time. And this letter has been reprinted a number of times in Chile because people there recognize that, let's say there weren't other diagnoses of the Chilean economy at that time that went into this kind of detail and in a professional way.

02-00:54:38

Burnett: Well, I guess an important piece of that history too is that Raul Prebisch at the Economic Commission for Latin America—

02-00:54:46

Harberger: I met him—

02-00:54:47

Burnett: You met him?

02-00:54:47

Harberger: —on that first visit.

02-00:54:51

Burnett: Okay.

02-00:54:51

Harberger:

And of course our line was quite counter to his line. Even though he was a very honorable and good person, the pitch of import-substituting industrialization is something that I think was proved in Latin America to be a failed policy. And we realized that with liberalization and so on, much greater economic growth took place, much greater benefit came to people, and it's amazing how at that time, it was so hard to convince people of these things. I'm going to give you just a little twist of how we went about this. It's a triangle story [laughter].

02-00:55:57

Burnett:

Oh, great. Great [laughter].

02-00:56:00

Harberger:

If you—the easy way, the didactic way is to think of a big uniform tariff. So you're only talking about imports and exports and you have this underlying pressure of a market that, in the end, the only way you can pay for imports is by exports. You can borrow to pay for imports today but then you have to export tomorrow, but you still pay in exports. So that's the basis of our model. And we have let's say the exchange rate is 10 pesos to the dollar. So the exporter gets 10 pesos for every dollar that he produces. But the—when that dollar is used for imports the consumer has to pay 15, fifteen pesos.

02-00:56:59

Burnett:

Pesos.

02-00:57:01

Harberger:

So you've got this distortion, this gap. Now as you lower that to a 40 percent then you have the gap only being four points and then only three and then only two and then zero points, you see. In this process, you have an equilibrium with low imports *and* low exports in a constrained economy. And in a freer economy, you have higher imports *and* higher exports. And in this process, importers are paying less. People who buy imports are paying less for what they consume of imports, and the exporters are getting more. So liberalization is to say we're going to get more exports instead of these import-substituting inefficient operations. So exports produce efficiently, substituting for import substitution, which is inefficient. That was the pitch that we took and which is good economics and which was the rationale for the Washington Consensus, if you want to put it that way [laughter].

02-00:58:18

Burnett:

Right, down the road. Yeah. I guess the appeal for import-substitution industrialization—his analysis of declining terms of trade is—

02-00:58:32

Harberger:

Yeah, well, that part is basically garbage.

02-00:58:37

Burnett:

Okay [laughter].

02-00:58:37

Harberger:

But I'm going on his side now. They had two events: the Great Depression and World War II. In the Great Depression, the prices of commodities went to the floor. The free-market price of a dollar, so to speak, would go up because with such low prices of copper, wheat, meat, coffee, whatever they were exporting in Latin America, those low prices gave them few dollars which then became expensive and even in a free market there would be industrialization wanting to happen for that reason.

Then you get to World War II and the world economy was all distorted and we were not producing refrigerators, nor were we producing cars, so they had isolation. And I think both of these things can be thought of as having been the proximate triggers for the idea of import-substituting industrialization while the long-term trends of trade and all of that doesn't have any true support even in the data.

02-01:00:18

Burnett:

But it's this twin trauma that sort of sets them on that road.

02-01:00:21

Harberger:

Yeah, that started it all. And gives you a reason to at least be a bit generous—to Prebisch, I mean, not to say that import substitution [laughter] was a good idea when he was promoting it after the war.

02-01:00:44

Burnett:

Yeah, I guess it had appeal beyond Latin America, did it not?

02-01:00:48

Harberger:

Of course. Every—

02-01:00:50

Burnett:

And this is a time, just to get to sense of context, the Bandung conference is in 1955. There's this "non-aligned Third World" as it's called, that emerges.

02-01:01:03

Harberger:

When we get to India you'll see that we have it all over there too. [laughter]

02-01:01:06

Burnett:

Right. And there is a narrative that the dominant industrialized West, its interaction with these countries is either colonial or post-colonial and it seeks to re-establish these relationships of maintaining these peripheral countries as hewers of wood and drawers of water. That's the narrative, right, and that leads to all of these claims about autarky, right, control of our national resources. And in a sense that's what Chicago economists were facing going into South America, going into these places. There were these pervasive narratives of needing to industrialize behind high tariff walls or diversifying their economies through planned interventions in the market. And you needed to—you were thinking of how you can develop, well, I'll pose that as a question [laughter].

02-01:02:20

Harberger:

Well I will, just to give you from other Latin American countries, that in Columbia at one point they had high import-substituting legislation—actually including a prohibited list of imports. They also had a policy that said, well, if a company starts and it produces something that is not already being produced in this country to substitute against the imports, that when that company gets established, they will get a prohibition of imports of that commodity. So that was [laughter] something that really bothered— but it got to the point where the prohibited list got to be so long that they got rid of the prohibited list and went with a smaller permitted list instead [laughter].

02-01:03:36

Burnett:

Because the products that they were producing—

02-01:03:38

Harberger:

That the permitted list was shorter than the prohibited list [laughter].

02-01:03:39

Burnett:

[laughter]

02-01:03:44

Harberger:

[laughter]

02-01:03:46

Burnett:

And that led to—

02-01:03:46

Harberger:

That's how crazy things got.

02-01:03:48

Burnett:

Right, right. And so this is a, I guess it impressed you at a personal level seeing this is how people—this is how economies are being run. Did it bring it home to you that this was not abstract?

02-01:04:04

Harberger:

This was not abstract. And I had such a wonderful experience, I mean in that period, Oz (Oswald H.) Brownlee was the professor at Minnesota, but he was there for a year as economic advisor to Pat (Albion) Patterson in ICA [International Cooperation Agency].

02-01:04:26

Burnett:

Okay.

02-01:04:26

Harberger:

And Martin Bailey was a colleague of mine and he was there with Rosalie at that time. So the three of us got together more than once a week and but the main thing was that our hosts between ICA people, and the Catholic University people, and my friends that I made while I was in Chile, that we got taken up to Chuquicamata and Pedro de Valdivia, the nitrate mines, and the copper mines—

02-01:05:13

Burnett: Copper, yeah.

02-01:05:13

Harberger: —the coal mines in Concepcion. We went to all of these places and saw firsthand what was going on there. I went to maybe 20 factories in Chile. Factories that were producing textiles, shoes, refrigerators, this, that, the other thing, and I had lunches at the Union Club many times. I have to tell a story about the Union Club because one of the things that I have always been exceedingly proud of in the United States is how many of our high leaders both in government and business came from humble surroundings, humble backgrounds. I mean look at our presidents — Roosevelt was rich, Truman was poor, Eisenhower was poor, Kennedy was rich, Johnson was at least in the middle.

02-01:06:25

Burnett: Yeah [laughter].

02-01:06:25

Harberger: Nixon was poor [laughter], Ford was I think poor. Carter maybe in the middle.

02-01:06:38

Burnett: Right, a farmer.

02-01:06:46

Harberger: [laughter] But Reagan was poor.

02-01:06:48

Burnett: In origin, yeah.

02-01:06:49

Harberger: And so it goes. So anyway — I'm very proud of that. So anyway, I get to this Union Club now. And by the way, of the United States Fortune 500 leaders, half probably come from below the two-thirds point in the income distribution. So I go to Chile, and I'm here in the Union Club and in the agricultural sector they have the farm workers. They are *inquilinos* if they live on the farm and they are *afuerinos* if they live off the farm and come in just to work. But most farm workers were *inquilinos*; they lived on the farm, like serfs in a way. Okay. So I'm here in this union club and some big lunch with 10 people around the table or something like that and I innocently, truly innocently, asked how many members of this club are children of *inquilinos* [miming shock, laughter] They practically fell off their chairs; it was inconceivable to them that any would be. And I am sad to say that sometime after 2000 I was in the Union Club again and I asked the same question, a little bit snidely [laughter]—

02-01:08:20

Burnett: [laughter]

02-01:08:20

Harberger:

—and I had almost the same reaction. I mean in spite of the tremendous social mobility there has been in Chile, the great advances, all these good things, it was still true in the 2000 to 2010 era that it was not really conceivable that a child of an *inquilino* would be a member of the Union Club [laughter].

02-01:08:51

Burnett:

So a kind of concentrated agricultural sector, shall we say, and a not highly diversified industrial sector in the sense that a huge proportion of the government revenue, for example, came from just the copper industry, right, at that time so—

02-01:09:13

Harberger:

Well, and that's still true to this day, I mean it's amazing to the extent, you see, copper was nationalized and went through all sorts of twists. But the nationalized copper CODELCO is still a nationalized industry. But it only owns the mines that it had when it was nationalized. But subsequently, private mining was permitted. So the copper coming from CODELCO is supplemented by copper now coming from private mines that have been established after the period of nationalization. And so, even today, copper accounts for half, depending on the price of copper, but it can get to well more than half of Chilean export revenues, yeah.

02-01:10:06

Burnett:

Right. But as you encountered it in the mid-1950s, it was an economy that was not highly diversified, shall we say?

02-01:10:15

Harberger:

Absolutely.

02-01:10:15

Burnett:

Right. So this is something that you're encountering?

02-01:10:19

Harberger:

Monocultural.

02-01:10:22

Burnett:

And so—we'll talk about development a bit more as we go along—but there was an understanding that the technical assistance that could be offered by having Chicago economics established at that university, that that was at least going to change the conversation in Chile about what was possible?

02-01:10:58

Harberger:

Well, I mean, you can look on our Chile operation as something that said we wanted to put good economics in Chile. That's what *we* wanted to do. Pat [Albion] Patterson thought that this was what the country needed. Now, what kind of dreams you want to further build on that, well, it depends on who was thinking and what was the conversation at the time. I'm sure that AID [Agency for International Development], or ICA at that time, in financing it, thought that this was a way of helping the future development of the Chilean

economy. I don't think there's any question about that. I think we thought that there were many things that good economics would help to modify policy in order to make things better. We all felt that. But, let's say, if you look at our job, our job was to transmit good economics [laughter].

02-01:12:29

Burnett:

Right. Exactly. Well, there were all kinds of, already by the mid-1950s there were social scientists in the United States who were thinking about development. There was the Department of Social Relations at Harvard, there's Talcott Parsons, and so some of the narratives that are coming out in the 1950s have to do with a total transformation of a society. And this is—they're talking I think about other countries, but they see that modernization is this complete cultural transformation. So the sense I'm getting from you is that early on in the Chile project, this was not considered really a development project in that kind of sense, right, where there was a need for a complete "Big Push" for example.

02-01:13:42

Harberger:

Well, I mean I think a lot of this need for complete transformation comes from looking very disparagingly at the existing populations. Or that they look at Africa and they think they're cooking enemies in pots instead of being graduates of Cambridge and Oxford [laughter] and—

02-01:14:13

Burnett:

Right [laughter].

02-01:14:13

Harberger:

But there was a lot of that and I think those of us who have had ample exposure from people from even very low-level developing countries, meaning low per-capita-income, developing countries that happily, happily, more and more through time, have elites who are well educated and well-motivated. You can get well educated elites that just [laughter] grab for themselves, and there's too much of that still floating around, but in any case we recognized that we were dealing with a civilized country, and a country with a legitimate history in an intellectual sense, and great artistic and literary developments, and so on.

02-01:16:05

Burnett:

Can you talk about the social aspect of this kind of work?

02-01:16:19

Harberger:

Ah, Chile!

02-01:16:20

Burnett:

[laughter]

02-01:16:20

Harberger:

Chile is the most hospitable country in the world, in my opinion by personal experience. I was there as a bachelor. And in the course of two and a half to three months I was invited to at least 30 different Chilean homes for dinner or

lunch. And most of these homes had nothing whatsoever to do with my work. Why did I get there? From the *Club de Bridge de Chile*. They had a bridge club (duplicate bridge) and they met in a hotel downtown. But whereas here you played 26 hands of bridge just straight in a row and then you total up the score and have winners and seconds and thirds and so on. There you played 13 hands and then you would break for dinner. And then you'd play 13 more hands. Well, as you broke for dinner you would just be sitting at a table with this couple or, I mean there would be four people or six people at a table and you'd be having conversation. And that's where most of my invitations would come from. So just, out of the blue, this stranger in Chile gets invited here, there, and everywhere. And other people have had similar experiences. When I go to Argentina, I don't get the same. Brazil, I don't get the same. In Latin America, what's the difference?

02-01:18:29

Burnett: [laughter]

02-01:18:30

Harberger: Valparaiso was around the Horn. No news from Europe got to Chile except by ships coming around Cape Horn up to Valparaiso. When these ships would come and the people in Viña del Mar and Valparaiso, the leading families were eager to invite the captain of the ship, the first mate, the second mate, the boatswain, anybody [laughter]. That was the great event to have one of those people. I'm 100 percent sure that this tradition in Chile goes back to those days when the foreigner was just a treasure to have. And it's an experience that I didn't have in any other country that I visited.

02-01:19:32

Burnett: So you weren't just making friends with economists?

02-01:19:34

Harberger: No. In fact the Club de Bridge was where I met Jorge Guzman. And Jorge Guzman was the manager of the manufacturers association, so to speak. He wasn't the big leader, but he was the operative person and he is the one who took me around to a lot of factories and so on while I was there, and was a long-time friend. In fact, we had his daughter come to live with us in Chicago for a period of time.

02-01:20:15

Burnett: How wonderful. So these are connections that you maintained and developed further. You have a multi-decade—

02-01:20:24

Harberger: Yes, but most of my connections in Chile are former students and former colleagues and so on, but Jorge was a very special one on the outside of that. And there were others that were more evanescent, that I just got invited to dinner here or a lunch there and so on.

02-01:20:44

Burnett:

So you've established a relationship with the Catholic University, and a contract is signed and the beginnings of some training and then I also understand there were—were people coming to the University of Chicago, or is that something that happens later?

02-01:21:03

Harberger:

Oh, that's the most important. I mean the big, I told you that the research part that we did in Chile was a dream that didn't really pan out the way, I don't think we did any bad research, but it was nothing like what T.W. had in mind, okay.

On the other hand, the training in Chicago, there has been no university-university arrangement I think that has been so lucky as we were in that first batch of Chileans that we had. These were Chileans that were rather poorly trained in economics when they came, but they were people who became ministers. Sergio De Castro was the leader of the great liberalization that took place in Chile in the 1970s. He was one of the first.

Ernesto Fontaine is without doubt Latin America's greatest writer of price theory, and greatest worker in the field of project evaluation and cost-benefit analysis. He was another of the first to come. Rolf Luders was just a year later but he became bi-minister with portfolios both in finance and the economy and is today an internationally well-known person, going to conferences all over the world and goodness knows what.

But this batch that came right at the beginning just happened to have human capital that we had nothing to do with, so to speak, just but sheer personalities and abilities to later flourish and be able to do so many great things. So they came and—

02-01:23:10

Burnett:

In '56 or later?

02-01:23:10

Harberger:

Well, they came. Well, 1956 was the first batch and when they came there were four of them Sergio De Castro, Ernesto Fontaine, Luis Arturo Fuenzalida and Pedro Jeftanovic. They had an apartment on Kimbark Avenue and in this apartment they had parties every Saturday night except at exam time. They worked until midnight every other night of the week, but on Saturday night there was this blast at this apartment. And the police would often come because the neighbors would complain, but they sort of took turns answering the police you see, so the police would knock on the door and Fuenzalida would come. Then the next time, De Castro would come. Then the next time Fontaine would come [laughter] so they were not repeat offenders.

02-01:24:21

Burnett:

[laughter] Each one got a warning?

02-01:24:24

Harberger:

Goodness knows what. But in any case I would go to all of these parties and Carl Christ, who was a good colleague that we'll probably talk about more, he came, and in any case at one of these things in October of '57, who is there but Anita. She was a teaching assistant at Northwestern. And they sort of found her through the Chile consulate—

02-01:25:08

Burnett:

Network.

02-01:25:08

Harberger:

—kind of network, yeah. And they had her there and I met her. I was with another date at that meeting and she thought I was married to that other date but I wasn't. And in any case I pursued her after that. And we only knew each other for about, well, from October the 12th until Christmas. She came to visit my family at Christmas and by that time we were going to get married.

02-01:25:39

Burnett:

Wow.

02-01:25:41

Harberger:

And but I had to go off to England on a Guggenheim and Fulbright combination. I was going to LSE [London School of Economics] for the winter quarter and to Cambridge for the spring term. And she couldn't get away from her teaching-assistant duties for the winter quarter so she had to stay. And so we had this very interesting thing. We were going to get married and I said well, we might get married civilly. It turned out for a civil marriage you had to have blood tests six weeks before and goodness knows what. But you didn't need these for a church marriage. And my parents and her parents, her mother, would all have preferred a church marriage anyway, so I was staying in a Shaftsbury Hotel and I was walking through Covent Garden to the LSE every day and right there in the corner was St. Martin-in-the-Fields. So I went into St. Martin-in-the-Fields and asked if they could marry us. The vicar there said, "Yes, we would be happy to marry you, but we have to read the banns for six weeks before." So they were reading the banns about "Arnold Harberger, bachelor, of the Shaftsbury Hotel and Ana Valjalo, spinster, of [laughter] such and such an address in Evanston, Illinois. Anyone who has complaints against the character of either of these should please come forward."

02-01:27:52

Burnett:

[laughter] Is this read out in—

02-01:27:54

Harberger:

I don't remember. I wasn't there. But that's what they said they had to read the banns. So in any case, on the 15th of March I go to the airport in the morning to receive Anita. And we got to the hotel where we are going to be staying for a couple of nights and in the afternoon we have the wedding at St. Martin-in-the-Fields.

- 02-01:28:30
Burnett: St. Martin-in-the-Fields, wow.
- 02-01:28:31
Harberger: And Lionel Robbins gives away the bride, who is a leading doyen of economics in England at that time. My best man was Richard Stone, who later became “Sir” Richard Stone, who later got the Nobel Prize. And the only audience were economists friends of mine and their spouses [laughter] because they were the only people I knew.
- 02-01:28:58
Burnett: Right. Right. Exactly.
- 02-01:29:01
Harberger: And we had a reception in the Charing Cross Hotel right across the street. And it was just a great event.
- 02-01:29:12
Burnett: Wonderful.
- 02-01:29:12
Harberger: And later Lionel Robbins took a great liking to Anita who was very interested in art and Lionel was a director of the National Gallery. And so when we were at Cambridge after having been married and having gone on our honeymoon, he invited us to come back and he opened the National Gallery with a key on a Sunday morning to show Anita and me through the National Gallery—
- 02-01:29:48
Burnett: Oh, my goodness.
- 02-01:29:48
Harberger: —all by ourselves—
- 02-01:29:50
Burnett: Wow.
- 02-01:29:50
Harberger: He was also a director of the Covent Garden Opera and he and his wife invited me when I was there alone to the opera in their box to watch—
- 02-01:30:05
Burnett: Oh my goodness. Wow.
- 02-01:30:06
Harberger: —[laughter] *La Bohème*.
- 02-01:30:08
Burnett: Oh, wow. It’s such a romantic story, and amongst all of this career action and movements around the world that you had at this time, that was made so special. That’s really, really fantastic.

02-01:30:26

Harberger:

Yeah, and then when we had our honeymoon. And on our honeymoon we went to Paris first. And then we went to Bern, Switzerland where we looked up some relatives of my grandparents, and we saw the place where the failed bakery was located—

02-01:30:54

Burnett:

Really?

02-00:00:23

Harberger:

—where my grandfather's family. And then we went to Vienna, where we saw Karl Harberger who was a relative of Ferdinand Harberger, my other grandfather who came from Vienna. We met with that family there. And then we went to Athens. And the—my part of this honeymoon was paid for—not totally, but the airfares and so on, some of them were paid for by Fulbright because I lectured for Fulbright in Greece.

So I get to Athens, and get in a hotel, and we barely get ourselves sort of set up in the hotel, and I get a call. Professor Sparounis is downstairs and he is going to translate for me. So I go downstairs and I sit with Professor Sparounis. And he tells me well, I love America, and I was in America at such and such a time, and I have this daughter, and this daughter went to America and this is—it just went on and on for an hour. And I said, “Well, I'm going to tell you what I'm going to talk about, technical advance, economic growth.” And I tried many times to introduce that theme, and he would go on and on in his own thing.

So I go up to our room. And then the following night we have this lecture. And I start talking about technical advances and economic growth, and the Solow model, and work of prior work of T. W. Schultz, and Denison, and Kendrick, and others, and doing the measurement of technical advance in the United States and so on. And he's translating for me. And I talk for two minutes, and he talks for three or four. And then I talk for two, and he talks for three or four. All of the sudden, I'm talking about technical advance and I hear “Sputnik” [laughter]. And then I hear something else like that, and I do a double take.

Well, it turns out there were two lectures. One was my lecture in English on technical advances and economic growth, and another was his on the United States, wonderful country, and the leadership, and the rivalry with the Soviet Union [laughter] and all that. So a fellow named, I think his name was Mamalakis was a former student at Chicago and was there and was so terribly embarrassed that he organized the following night another audience for me to lecture again [laughter] with translation by himself [laughter].

02-01:34:24

Burnett:

This time verbatim [laughter].

02-01:34:27

Harberger:

And so then we went to Izmir where Jim Johnston who had been my roommate was consul in Izmir and they took us to the ruins and so on. They had a baby. We had a wonderful on the grass picnic among the ruins—

02-01:34:57

Burnett:

Oh, my goodness.

02-01:34:59

Harberger:

—in Izmir and then we went to Istanbul and then to Cyprus where we heard shots in the civil war that was going on in Cyprus at the time. And we were close enough to the shots that we actually heard them. And then finally, to Israel where Don Patinkin—Don had been my teacher in a money course in Chicago. And he was later dean of Hebrew University Business School and still later Rector of Hebrew University before he finally died. But anyway, we stayed with Don and Devora, his wife and they took us to the stadium of the Hebrew University where there was the national celebration of the 10th anniversary of Israeli independence.

02-01:36:02

Burnett:

Wow.

02-00:00:23

Harberger:

And we sat through a whole afternoon of parades there and I remember I had to take a handkerchief and cover my head to shade myself from the hot sun because I had no hat. But it was all very impressive, and most impressive to us were the female soldiers marching. They had tanks and they had male soldiers marching and that was impressive enough, but here were these women. There they were and it was sort of amazing to us. And then the Central Bank made available to us a car for us two and a driver to take us to the south through the Negev desert down to the port of Eilat. But we had a wonderful time on this trip and then back we get to Cambridge and there is Dick Stone. Dick—how Dick Stone got into the picture had been that he was a visiting professor at Hopkins for a year. Maybe it wasn't the full year. Maybe it was a term, but anyway he came without his wife and I was a bachelor at that time. So I was the social group [laughter]—

02-01:37:41

Burnett:

You were the social committee of one.

02-01:37:42

Harberger:

—for Dick Stone. We did things together but when not doing things together we came to my apartment and drank his favorite American wine which was—he was quite a connoisseur. What was his favorite? Roma white [laughter].

02-01:38:02

Burnett:

Oh, wow. The California—

- 02-01:38:05
Harberger: And he loved Roma white vis-à-vis the *vin ordinaire* he was used to in England. And the difference between Roma white and *vin ordinaire* was that Roma white was always the same [laughter].
- 02-01:38:23
Burnett: [laughter]
- 02-01:38:23
Harberger: And it was good wine. It wasn't a great wine, but it was a good wine. And the idea that you could just absolutely rely on this Roma white terribly impressed this Englishman [laughter].
- 02-01:38:38
Burnett: [laughter] The predictable quality control of industrialized American wine production.
- 02-01:38:44
Harberger: Yes.
- 02-01:38:46
Burnett: [laughter] Well, so you had a wonderful month. It was a month-long honeymoon?
- 02-01:38:50
Harberger: Month long, yeah.
- 02-01:38:51
Burnett: And you saw all of these people and I guess the Fulbright when one of the—
- 02-01:38:56
Harberger: So I gave a lecture for Fulbright in Israel too.
- 02-01:38:57
Burnett: In Israel as well.
- 02-01:38:59
Harberger: In Athens and in Jerusalem.
- 02-01:39:03
Burnett: And this was the golden age of American travelers abroad. It was just a wonderful time for you to go and see all of these places.
- 02-01:39:12
Harberger: Yeah.
- 02-01:39:13
Burnett: And so you're married now?
- 02-01:39:16
Harberger: So now I'm married, and we're in Cambridge. We get installed in Cambridge. And I don't have—I gave a couple of lectures in Cambridge, but I guess the

one of the highlights was that—Dick was a fellow of King’s College, Cambridge—and I was made sort of an honorary fellow and therefore eligible to eat at high table. And the high table, the plebes are down there, you see and there’s a little platform and literally a high table.

02-01:40:01

Harberger:

And the faculty and fellows are called. They sit around this rather large table for maybe 20 people, and they serve very nice lunches, and very nice dinners. And notable to me was that they had this silver wine kind of train, that had wheels, and the bottles of different wines would sit on this. And then they would—this would go around the table with the wheels sending it around, and people would take the wine that they preferred with the course in question. Or after dinner, did you have sherry, or port, or dry sherry, or a sweeter sherry [laughter]? That also impressed me.

02-01:41:03

Burnett:

So a wonderful set of experiences.

02-01:41:07

Harberger:

And then on the weekends, we could take long weekends because I didn’t have any real duties so we had three-day weekends most of the time. And we rented a [Austin] Mini Minor and at a very cheap price, and we would put 500 miles per weekend on this thing. In the rental agency [laughter], their eyes popped out when we came back, delivered the car with so many miles but we went everywhere in England. We went to Penzance on one weekend, and to York on another. And had just a wonderful time and saw just about everything.

02-01:41:58

Burnett:

That’s wonderful.

02-01:41:59

Harberger:

And then we had the summer. In the summer when the term ended we went to Newcastle-on-Tyne, took a boat to Bergen, went from Bergen to Oslo and saw Oslo and so on and then came back to Bergen and we sailed up to the North Cape area. We saw the Arctic, the midnight sun over the Arctic Ocean looking out from the cliffs in the North Cape and then came back to Hammerfest. From Hammerfest we went to Luleå in Sweden and all the way to Stockholm. And then we went across to Finland and we went up in Finland to the north maybe it was that time we went to the North Cape and then Hammerfest. I think that’s the case. And then we came back to Sweden a second time and over to Copenhagen and then to through Germany. In Germany, we saw a former prisoner whose name was Jakob Fuchs. He was sort of crazy. He was the clerk of the battalion on the German side. We had four Germans in the headquarters and he was the clerk. And he had a child and he would get American magazines and he would see animals and he would cut out these animals and paste them on plywood and then with a coping saw he would saw them out. So he had a whole menagerie of animals that he was making for his

son. And then he had a diary he had kept all the way through his war experience and into the prisoner experience. And he made a copy of this diary which he gave to me to in case they took his copy away when he was being sent back. And so in any case when we got to Augsburg, I looked him up and he had been an oddball in his own way. When he talked to you, he put nose to nose. You know people like that?

02-01:45:00

Burnett: Yeah.

02-01:45:02

Harberger: Okay. So when he greeted us [laughter] it was nose to nose. And here he had been collecting all these things. So he takes me and he shows me his collection of fish, a huge aquarium with all kinds of fish. And he's pointing out all of these varieties.

02-01:45:19

Burnett: Wow.

02-01:45:19

Harberger: Then he said I'm going to show you my encyclopedia. So he takes us to another room, and in this room there are all this kind of loose-leaf notebook things with the big three-inch-thick loose-leaf—

02-01:45:36

Burnett: Yeah, binders.

02-01:45:36

Harberger: Binders. And what he has is things—he cuts out an article about the Antarctic from the National Geographic, let's say. And then he cuts out an article about the American president from Look magazine. Then he cuts out something from *Der Spiegel*, but he had 50 binders full of everything that you wanted to know about. An encyclopedia that he had made all by himself [laughter].

02-01:46:12

Harberger: So there it was. So from there we go to Florence in Italy and we see all of the—

02-01:46:27

Burnett: The Uffizi and the—

02-01:46:27

Harberger: Uffizi gallery and the Ponte Vecchio is up there and all those things. And then we go to Rome and then to Naples. And then we take a boat from Naples all the way up to Genoa and then around the French Riviera and finally to Barcelona. We spend a few days, several days in Barcelona. Then we go to the beach at Sitges, which is the Spanish Riviera, so to speak. Then we take a bus tour down to Valencia and Seville and Cordoba and see the gypsies in their caves and goodness knows what. Then we take a train to Madrid and we

stay in Madrid for nearly two weeks. And finally, we go to Chile for three months [laughter].

02-01:47:34

Burnett: Wow.

02-01:47:35

Harberger: And then we have this three-month—I had a beard at that time. Anita, as you probably saw pictures, she was very beautiful. And the people would look at her a lot and she wanted to spread that misery or something, so she had me grow a beard. So I had a beard. And we went to Chile with this beard and that was a time when you were kind of a hippie if you wore a beard.

02-01:48:06

Burnett: Right. It was a beatnik—

02-01:48:08

Harberger: Yeah, and so I arrive in Chile with the beard, but this was my second stay on our project. And I was going to see the president of the Central Bank and the ministers and all that. And I didn't think it was right to be wearing this hippie beard when in [laughter] those august halls, so I shaved it off at that point. But you can see what a year that was.

02-01:48:45

Burnett: Tremendous. And so you're in your mid-thirties now and it's kind of dizzying. You were a professor of economics at Chicago, and you've done all this incredible research in these different domains about national economies and international adjustments in markets and so on. Apart from the tremendous personal growth and the personal impact of being married and going on this wonderful honeymoon, did seeing all those different countries, different cultures, different sites, did that have an impact on how you understood economies a little bit?

02-01:49:37

Harberger: Well, I would put it a different way. When I was in England I got to understand England, really. Because when I was there alone in London I must have walked, let's say 80 days and I had to be walking at least five miles a day [laughter]. I walked through every part of London and I saw everything, and if you went to theaters and usually they had unsold seats, and if you shopped around, you go to one "no seat, no seat, no seat." Here or there they had a seat, so I saw nearly every play that was around in London at that time. And just had a good sense of the way, how people break for coffee in the morning, and for tea in the afternoon and how these are institutions at every university not just at LSE [London School of Economics], but we go to give a lecture somewhere else and then we had the same thing and the attitudes that people had and so on. And that sense of feeling in a sense at home or at least truly knowing what it's all about in English society and the economy. And that same sort of feeling I got as I went through these different countries obviously

to a lesser degree because I was only there for a week or less than a week and so on.

Spain, we had a very in-depth appreciation for the Spanish economy and society and so on. So I think that, did I have a changed view of what international economics was all about? No. Did I have an understanding of what each of these economies was like and each of these societies was like, yes, you see. That was it. And I really treasure this sort of, to get that on-site feeling. Many economists really get full satisfaction, so to speak, out of reading this in books or so on. And [laughter] not me.

02-01:53:04

Burnett: Well, let's pick up this afternoon.

02-01:53:09

Harberger: Okay, good.

Session 2B, Afternoon

02-01:53:10

Burnett: This is Paul Burnett interviewing Dr. Arnold Harberger for the Economist's Life Stories Project, and this is still September 22, 2015. So Dr. Harberger we just finished talking about your whirlwind tour with your new wife, Anita, but I did want to ask you to talk a little bit about your time at the London School of Economics and the people you met—you talked about Lionel Robbins a little bit—but in terms of professional ties and the kind of conversations that were happening there that you were tapping into. If you could talk a little bit about that that would be great.

02-01:53:50

Harberger: Yes, well, did we talk on camera about the Lionel Robbins seminar?

02-01:53:58

Burnett: No.

02-01:53:58

Harberger: I don't think so, yeah. Well, at LSE I joined this Lionel Robbins seminar and it was about so-called "new welfare economics" and the new welfare economics had made itself different by questioning the "old welfare economics," so to speak. And this seminar met weekly while I was there and I was actually getting a little bit antsy because they were going so slow and taking so seriously all of these nit-picking comments about how the new welfare economics was going to be different from the old welfare economics and so on, when really it had no concrete thing to offer, nothing to give to the practitioner in the field who was trying to do something with this stuff. In the end, they came to the right conclusions but it sort of took the whole [laughter] semester to get to where I would have tried to get in one lecture. But it was a very interesting experience. This was the British way of doing things, the old

university way and the great professor leading the graduate students and so on. It was wonderful in that regard as a sociological observation, so to speak.

02-01:55:46

Burnett:

So briefly, what characterized the old welfare economics and what were they trying to do, just from a bird's-eye-view sense, what were they trying to do with new welfare economics? How was it to be different?

02-01:56:05

Harberger:

The basic idea was that the old welfare economics was based on the assumption of the constant marginal utility of income, which it is not really. I mean if you were to interpret it properly, or, put it another way, that at the very worst, the issues of changes in the marginal utility of income would mean that when you're tracing one of these triangles, that if we count the first step as one hundred, the second step would be 99 and the third would be 98. So you'll take a little sliver off of that triangle because of these changes in the marginal utility of money, nothing! But the way it was put in the literature, this was a fatal flaw [laughter]!

02-01:57:17

Burnett:

Right [laughter]. And so was it that some were interpreting it in a way that was different from your interpretation or they were just not connecting it to the real world?

02-01:57:26

Harberger:

Well, they're just saying that in proving the invalidity of the "old" system period, you see.

02-01:57:34

Burnett:

Okay.

02-01:57:34

Harberger:

That we don't like this because it is flawed [laughter]. And my answer is "well, if it's flawed, how much is it flawed, and how do we adjust for the flaw?" [laughter]

02-01:57:47

Burnett:

Right. So a different approach right there that you noticed. But it was stimulating, I imagine, even if you don't agree with the nit-picky nature of the discussions was it—did it lead you to—

02-01:58:03

Harberger:

Well, I didn't—it didn't teach me anything, let's put it that way.

02-01:58:07

Burnett:

Okay. Well, that in itself could be—

02-01:58:09

Harberger:

That literature did not teach me anything. The experience of being in Lionel Robbins' seminar was great, you see. But it was not the subject matter; it was the [laughter] gestalt.

02-01:58:21

Burnett:

[laughter] Okay, fair enough. Fair enough. So that was part of your travels and your sojourn that involved getting married and going on a honeymoon and then you returned to Chicago. And there's a couple of papers that come out in the late fifties. One we've already talked about a bit and it's in the Roy G. Francis volume called *The Population Ahead* and it's an article "Variations on a Theme by Malthus." And it's somewhat informed I think by your experience in the early fifties getting a sense of the resources, available resources at hand. Could you talk a little bit about the basic message that you wanted to impart? Why was this message necessary at that moment?

02-01:59:20

Harberger:

Well, the big—you see, Malthus' story was that as population grows, and we only have one earth. If the earth turns out to be more productive well, then people will be more reproductive, and ultimately a subsistence-level living will continue. And the great dependent variable will be population. Well that has been disproved so many times over in subsequent history that it's not even funny. But the modern theory of growth certainly makes it all quite clear that the economy grows in two ways: it grows by adding resources, namely labor and capital, and by finding cheaper way of doing things, which is innovation in all of its great variety. And early studies in this area basically showed surprisingly to some people that the increments of labor and capital that had had happened in the first half of the century, let's say, accounted for only about half of the growth, and the other half of the growth came from real cost reductions or innovations of various kinds. And that the end consequence of this was greater product and Malthus would certainly agree to that, but where Malthus was wrong was that human reproduction didn't eat it all up. And people really liked living better and the very interesting element that we may have learned at some point, I don't know at what point we really did learn this, but it is certainly true that people choose not to have more children when they have more income. It isn't that the children come automatically, and that starvation is the key limiting force. And the minute you have people choosing to have fewer children as they get richer [laughter], which seems to be the truth in the world, that we have a self-limiting element in the picture, and we have continuing increases in living standards all over the world. And we should be very happy with that.

02-02:02:44

Burnett:

Were there voices at the time in the 1950s when it came to economic development or interventions in countries—

02-02:02:53

Harberger:

Oh, there are always going to be Club of Rome-type things. Always. It's one of—there's always going to be people who see the world that way.

02-02:03:03

Burnett:

Right. In strict Malthusian terms.

02-02:03:04

Harberger:

Yeah.

02-02:03:06

Burnett:

And so the message in this article — research, innovations, that's going to be the limiting factor.

02-02:03:36

Harberger:

I would rather say determining whether growth will be faster or slower. Very clearly, and there's tremendous evidence to support this, that times when growth is enormously high are times when real cost reductions are enormously high and times when growth is very low is when we have even negative real cost reductions.

02-02:04:03

Harberger:

That's the biggest varying factor in the determination of economic growth in industries, in countries, in cities, whatever way you slice the pie so to speak, it always is true that this real cost reduction element is the source of big variation. And nowadays, I'm playing down human capital in that, at least in its direct form. Usually when you measure economic growth, the human capital element should be counted as a piece of the labor contribution to growth. See, what we do when we measure growth, we say we have ΔL , the change in labor and we assign a productivity to it, what is the productivity? The wage. So we have the wage times the change in labor plus the rate of return times the change in capital and then whatever is left is the real cost reduction part. Well, it's very simple, that if we say well, we don't have a single wage. Instead, we have the hod-carrier's wage times the change in hod carriers, the nurse's wage times the change in nurses, the doctor's wage times the change in doctors. The engineer's wage times the change in engineers. And there you have human capital built in as your labor force has more and more doctors and fewer and fewer hod carriers, you get a built in contribution of human capital formation to the labor force. Well, when we actually do this, we find that the labor contribution, measured crudely, might be one percent of growth, and when we make all these corrections for the addition of doctors, engineers, etc. at their respective earning powers, it becomes one and half, maybe two. But *never* more than two, you see.

And you can see how this is. You think of an engineer as being trained. He comes into the labor force, not much happens, but he's going to live in the labor force for 40 years, you see, so his contribution could be spread over 40 years. Well, the increment to growth in any single year is going to be tiny for that, even though it is a very worthwhile investment. And in economic terms,

the amount that's invested in educating him, including the wages that he fails to earn when he's studying in school, all at a cost, added onto all of those costs, there is a rate of return of maybe six percent, eight percent, 10 percent, 12 percent, sometimes, 15 percent. Even if it's a very high percentage that return, when you do the breakdown of growth and you have a one percent labor contribution, it becomes one and a half. Well, maybe you do a big effort and it becomes one point six [laughter]. So, it's a *sluggish* element. It's one that really pays in terms of economics, but people who think that through that device you're going to change economic growth from three percent to seven percent, forget it.

02-02:07:54

Burnett:

Right. Although, going back to the 1950s where your growth models are capital and labor, this is the beginning of research at Chicago— and I wanted to ask you, because this comes up in your '58 and '59 papers—it's not quite human capital but investment in research is part of the story in your conversations about economic growth in your writings. Shultz is working on that and he cites Zvi Griliches —

02-02:08:38

Harberger:

Hybrid corn. Zvi did that in my workshop.

02-02:08:39

Burnett:

This is the rates of return—

02-02:08:41

Harberger:

Through hybrid corn.

02-02:08:41

Burnett:

Right. And it's the famous 700 percent argument, right? There's a 7-dollar return on your one dollar of investment, in this case it was the state investment and private investment. And so that's in the workshop you were discussing this? So is this something that's in the air at Chicago and it's Schultz, it's Griliches, it's you? Who are the players talking about the investment in research and in essence human capital, before the fact?

02-02:09:23

Harberger:

Well, you see [laughter] it's very interesting. You're—I have to go back and study Griliches again.

02-02:09:36

Burnett:

Well, it's a leading question. So [laughter]—

02-02:09:39

Harberger:

My line on hybrid corn which I learned about only from Zvi is that hybrid corn is a really interesting little story because it turns out that the hybrid that works in DeKalb County doesn't work very well in neighboring counties. And you need to develop a different hybrid for the different counties. And when DeKalb County farmers are making a ton, the neighboring farmers are losing

money by planting that same corn and then somebody comes and develops a necessary hybrid—

02-02:10:35

Burnett: Re-hybridization. Yeah.

02-02:10:35

Harberger: —for that area and then it flourishes. So it's I think a more subtle story than one gets thinking well, they invent this hybrid corn and bang, bang, bang, everything happens. But it also means that as you look at the whole story the 700 percent turns out to be sort of exaggerated in that sense because it isn't counting those losses that are made in false steps that are really part of the whole process. The only reason you develop the new corn for the neighboring county is because you've tried the old one and it hasn't worked. But if you tried the one that worked in DeKalb County but it hasn't worked in the neighboring then, once you made that loss, then somebody comes and finds something that's better for you and so it goes.

02-02:11:36

Burnett: And that was done in your workshop?

02-02:11:40

Harberger: Yeah.

02-02:11:41

Burnett: It's interesting because T.W. Schultz takes that as evidence, right, and he uses this in *Transforming Traditional Agriculture*, and he uses it as this evidence for the investment in people, the investment in research that gives you the dividends that provide you real productivity gains.

02-02:12:01

Harberger: Correct. Yeah.

02-02:12:03

Burnett: So this is cooking in the workshops.

02-02:12:10

Harberger: This is really, yes, exactly. Yeah.

02-02:12:12

Burnett: Could you talk about—you've talked about some of the students a little bit could you talk about Zvi Griliches? Did you work with him and did you supervise his—

02-02:12:22

Harberger: Well, I was not on his committee, as I remember. I may have been, but he—my workshop was a place where smart people came for freedom [laughter].

02-02:12:32

Burnett: [laughter] That's right.

02-02:12:37

Harberger:

We talked about that. So I had Griliches on hybrid corn, I had [Marc] Nerlove on agricultural supply, I had Les [Lester] Telser on futures markets [laughter]. And I was very happy to have all these people. And I found some excuse to put these under public finance anyway [laughter]. Agricultural supply is very important because we have price supports and other subsidies to agriculture so we've—so we need to know about agricultural supply.

02-02:13:10

Burnett:

Right. So there's a lot of energy that's coming out of the workshop system, at least your workshop in the workshop system. Can you talk a little bit about how things unfold as you get into the beginning of the 1960s with the work with the Center for International Studies? How does that come about?

02-02:13:44

Harberger:

Okay. Well, I had been to Chile and had done some writing about Chile and so on. And I was invited by the MIT [Massachusetts Institute of Technology] Center for International Studies [CENIS] to spend a year at its office in New Delhi. They had a grant from Ford and Rockefeller together I think it was. And they invited people from all over the world to come. My year we had Nino Andreatta from Italy who later became a minister in Italy. We had Per Sevaldsen from Norway. We had Dick Eckaus from MIT and we had me from Chicago. The four of us were the staff so to speak of this international center. And this was linked to the Planning Commission of India. And we were there in order to serve the planning commission to help it in whatever ways we could. And there had been other professors prior. I remember Trevor Swan, who was quite an important economist from Australia, had been there previously. And there was Dick Stone's predecessor Brian Reddaway from his center in Cambridge. And we had I think a very nice, congenial group during my year. And our job was to do what we could to help the planning commission.

Well, when I got started there, there was this big, old, fat story of zero marginal productivity in labor in agriculture in India. W. Arthur Lewis, "Planning with Unlimited Supplies of Labor" was the article. And T. W. fought that tooth and nail by citing among other things evidence from the 1918-1919 flu epidemic. What he did was he looked at the different counties in India, different regional districts in India which had different levels of mortality in the labor force as a consequence of this flu epidemic. And so he tried to correct for the so-called monsoon, what were the weather conditions, and so he picked the two closest years that had similar weather conditions, one prior to, the other as soon as possible after this epidemic. And then he said well, how much did the labor supply change and how much did the output change? And he found that there was a very substantial effect of labor, that is to say the marginal product of labor was not zero but was something else. And guess what? It was approximated by the wage, which is what of course economics has always said.

So I came there and I was trying to fight the same battle, which was one of these snakes that you chop the head off and it keeps growing a new head every time and keeps coming up to bite you. So there they were, and what I found was not just one piece of evidence but a continuing body of evidence collected by the Indian statistical survey. They had everything. They had data on the labor force of India divided by region and all of that divided into different categories of labor. The lowest on the totem pole was landless labor in agriculture. Okay. So if there's going to be any great superfluity of labor in agriculture as W. Arthur Lewis would have us believe with zero marginal product, you would expect that the victims of this would be these poor landless laborers. Well, these surveys year after year after year show the average landless laborer in India is working 200 to 250 days per year, for a pittance of a wage to be sure, but his marginal product measured by his wage, though small by our standards, is not small by Indian income-per-capita standards. It's a one or two rupees a day. When we were there, the workers in the city would be getting two rupees a day and in the countryside would be getting one rupee a day, something like that. One rupee was 14 cents.

02-02:19:59

Harberger:

So in any case, this piece of evidence reflected a very significant demand — a willingness to pay for landless labor. I took this to be an absolutely definitive sort of spike in the heart of the idea of zero marginal product of labor. Well, then I did some other work on economic growth where I also pursued the same sort of story, that the zero-marginal-product of labor hypothesis says basically that everything is due to capital, and that everything will follow investment. Well, you had guy named Professor Mahalanobis, I don't know if you know that name—

02-02:21:00

Burnett:

Yeah, P.C., yeah.

02-02:20:59

Harberger:

—but he had great influence in the Planning Commission. I think he was chairman of the Planning Commission at one point but in any case he had this idea that everything depended on investment and they were building plans based on this notion. Our task was to try to convince him and his colleagues that no, it's labor *and* capital and [laughter] you shouldn't be attributing everything to capital. So I wrote early in my stay an article that said what the world would be like, if really, everything were due to capital, and that turned out to be a crazy world. The notion that everything is due to capital is just as odd as the Marxist idea that everything is due to labor [laughter].

02-02:21:55

Burnett:

Right. Right. Well the Lewis disguised unemployment hypothesis is kind of perfect emblem of a certain kind of development thinking that evolves—

02-02:22:08

Harberger:

Absolutely.

02-02:22:10

Burnett: —in the 1950s. There's what, in essence, development economics purports to be a separate kind of economics.

02-02:22:16

Harberger: Oh, yeah, people made—an MIT person actually, I forget his name but he made a big model of many sectors with input-output coefficients all over the place, but the whole underlying hypothesis was that the marginal productivity of labor was [laughter] zero in the key sector of the economy, yeah.

02-02:22:42

Burnett: And there's this kind of industrial fundamentalism I suppose, right?

02-02:22:49

Harberger: Yes!

02-02:22:49

Burnett: And that's—and part of it—

02-02:22:49

Harberger: Well, there were “mother machines.” What were “mother machines?” Well, you see if we want economic growth we build machines. And then we get the product of those machines over time. But suppose we build *machines* that build machines. These are the mother machines. And if we build these mother machines, then we're going to get generations of machines year after year. You see what I mean? And the whole crazy logic there that holds no water at all [laughter], that people were talking seriously about mother machines in planning in India [laughter].

02-02:23:45

Burnett: I find it striking because Arthur Lewis was arguing that there's this disguised unemployment in the countryside, so that precisely you could siphon them off to the cities, right? You get—

02-02:23:59

Harberger: Absolutely.

02-02:24:01

Burnett: —them out of the countryside and put them in factories, and that's going to be your take-off.

02-02:24:05

Harberger: I pursued this issue. And I'm glad you reminded me. The story is this: that we have this landless labor, which we have shown does not have zero productivity. But I say, yes, you can find zero productivity in Indian agriculture. Where do you find zero productivity? In family farms. So I have this classroom example where I have the family farm and I have marginal product of labor, a bar chart: the first laborer is their owner and that produces the most, then the next bar is lower, that's the first son; then comes the second son; and the wage is somewhere down here so—so he hires extra labor to the

point where the last laborer barely produces more than the wage so it's just barely profitable to hire that person. That's the first phase of the story.

Second phase. Now come cousins because we have the idea of the extended family in India and if a cousin knocks on your door you're supposed to take him in or her in, and do whatever is needed. So a cousin knocks so hired hand number one goes out and cousin number one comes in. Then comes another cousin and hired hand two goes out. A third cousin comes in. Hired hand three goes out. We still have marginal product greater than the wage. Or equal to it. Now comes cousin four, what do you do with him? Well, you take him in, obviously. And then cousins five, six, and seven. Well, you can get enough cousins in there that you'd rather have one sitting idle than having him getting in the way of the others in the field, so to speak. *There* you have zero marginal product of labor. But it's in a relatively middle-class Indian farm not the typical Indian farm, not the typical instance. You have this situation in a farm with those cousins, and one thing you can do is you can hire them out as labor to other farmers. So if you're a poor farmer and you have this excess of cousins you're going to send them as landless laborers. But if you're a middle class Indian farmer, Brahmin perhaps, you're not going to have your family going out as hired labor. So it's the Brahmin family [laughter] that has a plethora of cousins—

02-02:26:58

Burnett: Okay [laughter].

02-02:26:58

Harberger: —that gets into this situation, you see. So I am justifying the sort of sociology or whatever it is underlying zero marginal product. I'm saying zero marginal product can plausibly exist in Indian labor where it's very unlikely in American, or British, or other farms. But it's not going to be the poorest, it's not going to be very numerous. It's going to be these people who for reasons of family status are unwilling to have their family be landless laborers.

02-02:27:41

Burnett: And I think another piece of it too might be the demand side from leaders of developing countries who really, they almost didn't want to hear anything about agriculture it seems. They didn't want to hear anything, that's backwards; what they want is industry. Bring us factories. If you bring the factories then everything else—we'll leapfrog. We'll take all of the technological innovation that's come from the West and we'll be able to overstep some of this very, very rapidly.

02-02:28:14

Harberger: Something that actually happened [laughter] in the late 20th Century and early 21st, yes.

02-02:28:21

Burnett: But an expectation that it was going to happen [right away]—

02-02:28:24

Harberger:

What I'm saying is that under the circumstances of people trying to forecast and plan and approve at every point in time—in India in my time every import of equipment had to be prior-approved and every investment of any magnitude had to be prior-approved— so you had this whole bureaucratic process lying behind almost everything that people were doing. Enormous restrictions on imports, tremendous import-substitution protection, all of that was there. And it was just sad to see.

02-02:29:29

Burnett:

But at the time there was a tremendous sense of urgency in both the West and in this non-aligned world where—say, I'm a leader of a Third-World country, I need to produce results quickly because there's an alternative system out there competing for hearts and minds, right, saying “we industrialized, we the Soviet Union industrialized in about 10 years, and we did it quickly and we did it with industry and we did it with planning and we did it with the state.” So there's that as a kind of competition. Did you think about—was that in the back of your mind when you were going to these places, because that narrative is out there?

02-02:30:14

Harberger:

Well, there were certainly elements, I mean first of all Indian planning was in one way or another linked to Soviet-style planning. They had five-year plans and they talked about industries and they had this approval system and all of that. It wasn't as crazy as the Russian system, where the central bureau would set targets. Anne Krueger has a story about the time when the planners in Russia set the target for nails in tons of nails so everybody made these big, huge nails [laughter]. They had tons of them and none of the other types. Then they set targets by the number of nails and ended up with tons of little brads [laughter].

02-02:31:06

Burnett:

Little tacks [laughter].

02-02:31:07

Harberger:

So the economic system gives you prices and gives you clear incentives and great subtlety, but it is impossible to think of a planning bureau in Moscow or in New Delhi doing that. Well, India did not try to do that kind of thing, but they did imitate in certain ways the Soviet planning system, certainly in the five-year plan and in the approvals.

02-02:31:39

Burnett:

It also shapes some of the development folks who are not necessarily economists, but you were working through the Center for International Studies and, think of Walt Whitman Rostow's *Stages of Economic Growth*, right, the subtitle of which is “*A Non-Communist Manifesto*,” right?

02-02:32:03

Harberger:

[laughter]

02-02:32:05

Burnett:

So this idea that there has to be a competing counter-narrative of what the western way of doing things has to offer, but you have your problem of lags, right? You have your problem of things not panning out marketwise instantaneously.

02-02:32:25

Harberger:

Well, let's put it this way. Looking in light of history, we have no doubt that the Washington Consensus is the counter-narrative. And for all the things that have been said against the Washington Consensus, there are very few good experiences of growth that do not represent a move *toward* the Washington Consensus from wherever they were before.

02-02:23:53

Burnett:

Right. But at the time, you were dealing with a number of narratives of either trying to present—in competition with a kind of Soviet-style planning—some kind of narrative about the special needs of the non-aligned world.

02-02:33:19

Harberger:

Yeah, well, I think there's no doubt that the Cold War was an important determinant of foreign aid by most western countries that the—you definitely were doing your best to keep other countries from falling into the Soviet orbit. And that was good for the countries because at least the people who were trying to give this aid were aiming to make things better in those countries. They were certainly not trying to exploit those countries.

02-02:34:11

Burnett:

When Schultz wrote *Transforming Traditional Agriculture* in 1964, he wanted to have an approach to development—

02-02:34:27

Harberger:

Yeah, let me suggest where he was going with it.

02-02:34:32

Burnett:

Yeah, okay. Sure.

02-02:34:32

Harberger:

People, among other things, had the idea that peasants were really dumb. And Schultz didn't like that idea at all and didn't think it was really valid. His observation was that we have a thing we call a production function — a menu of possible things you can do and results that you will get if you in fact do them. And what Schultz and his researchers and students found over the years was that traditional agriculture was pretty rational. Based on whatever it had in its head, it behaved rationally. The issue was that when modernization took place and new techniques were developed, and new fertilizers and new inputs, the traditional farmers didn't know anything about that. And they certainly wouldn't just naturally be reading the *Wall Street Journal* or something like that and finding it. So the issue was to find ways of bringing new knowledge to this traditional agriculture and enabling it through experiment stations, through extension work, and so on to bring them up and bring new

technologies to their benefit. As such technologies arose and became adaptable to them, and of course, we have the Green Revolution in India taking place, and so on, the rice revolution as a result of research. All this was very big in T.W.'s feeling.

02-02:36:42

Burnett:

Yeah, it was.

02-02:36:42

Harberger:

Now to my story. While I was in India in the state of Maharashtra people were worried about malnutrition of children in poor villages. And there rose a project of giving school lunches in these poor villages in the hope of thereby improving nutrition and so on for these people. So this project had a lot of support. It was supported by the government of Maharashtra. It was supported by Canadian aid, supported by Swedish aid, I think supported by the Ford Foundation and so on. And it was very extensive. They covered something like 100 project villages. And India being full of very capable statisticians, they had a 100 control villages. The control villages were twins of the project. I mean if you had village A here you take village A' over here. And A' was similar in population, similar in the soil, and similar in all relevant respects to the project village. So each project village had its twin over here. And they started the project by taking the kids at school in each of these villages and testing them in various dimensions. How strong were they? How fast did they run? How tall were they? How did they behave on intelligence tests, et cetera? And all physical dimensions were there. So the project ran for something like five years and then they went back and did a re-test of these things to see how well the project had worked. And it turned out that in the mental dimensions, with the schooling business, the project had performed, but in the physical dimensions they were about the same in the project villages and in the other villages. What was the conclusion? The conclusion was that the kids were no better nourished with the school lunches or not much better nourished with the school lunches than without. What did that mean? That meant that the kids were getting less at home, as they were getting more in school. And that scandalized a lot of people, especially Swedish schoolmarm, so to speak, looking down their noses [laughter] at these parents. They had an image of the kid coming home, where there would be other kids in the family who weren't in this school, who had a full bowl of rice and the parents had a full bowl of rice and here this little kid from school looks at an empty bowl while the others all eat. It wasn't the way. What was the way? The way was that these illiterate Indian families figured out all to themselves, let's all have a smaller breakfast. Let's all have a smaller dinner and he at school will get his school lunch and we'll have a bigger lunch at home. And then the money that's being spent on the school lunch will be transformed into dowry for daughter Indra [laughter]. And that was the family priority, you see, to get the dowry money. So they did what economists should have seen in the first place, what a good undergraduate, first course in economics will tell you, that anybody receiving a gift in kind, if you give him the cash, can buy that gift, and if he would

prefer something else he will take something else so if you're just looking at it from his own point of view, cash is always better because he can do what he wants. And the corollary of that is that anytime somebody gets a gift in kind, it's in his personal interest to try to transform it into cash. And what were these illiterate families doing, was transforming the school lunch into cash for the daughter's dowry. A wonderful example of economics, and a perfect match for what Schultz was saying about the underlying rationality of these Indian peasants.

02-02:42:01

Burnett:

And they're being rational about the risks that they take because they can't afford the kind of experimentation that a wealthier farmer could take. And so the key is to price innovations. That's his big message is to price innovations so that poor farmers can experiment, right, or to give—

02-02:42:24

Harberger:

Maybe not to experiment.

02-02:42:25

Burnett:

Not experiment, but take advantage of innovation.

02-02:42:27

Harberger:

But to try to persuade them through demonstration, at best, that something that they have not tried yet is worth trying. One of the problems in Indian agriculture is that some of the holdings are so small, I mean, not some of them, the great majority of them, the holdings are so small that the idea of "well, let's take a few good acres and do this, and then the rest of your acres you can do the other way." "We've only got two acres." There's not much chance for that kind of experimentation.

02-02:43:09

Burnett:

No, absolutely. So you're obviously learning about this whole new world.

02-02:43:20

Harberger:

Exactly. This is just mindboggling, everything new, everything different. Well, let me start at the beginning. We were part of the diplomatic community. And so our offices, MIT offices, were in the diplomatic segment of town. And when there were diplomatic events we were invited along with the ambassadors and ministers and consuls and all of that. And we went to the Ramayana or whatever they call it, the great display of the story of Rama and the god Hanuman.

02-02:44:15

Harberger:

And so we saw that. But when Jackie Kennedy came shortly after we arrived we were invited to a reception, a garden reception by Prime Minister Nehru in honor of Jackie. And we stood in the line and shook her hand and so on. And Anita was always very attractive and Nehru was very observant of such things. And so he came especially over to us and admired Anita and saw that the baby was coming and made some comments about that and so on. And

then Anita said a few things about that and as he was ready to leave, he carried always a rose in his lapel of his Nehru jacket [laughter]—

02-02:45:11

Burnett: That's right.

02-02:45:11

Harberger: —and he took out his rose and he gave it to Anita to put in her hair [laughter]. How about that?

02-02:45:18

Burnett: He was a suave guy [laughter].

02-02:45:19

Harberger: [laughter] So—

02-02:45:27

Burnett: So and the work that was being undertaken there, you did your research on the marginal productivity of labor using the statistical series that the ministry had provided. And this is '61, '62 academic year?

02-02:45:47

Harberger: This is '61, '62, yes.

02-02:45:49

Burnett: Yeah.

02-02:45:50

Harberger: And another thing that the once the planning commission got the idea that I was into project evaluation and worrying about how I studied the rate of return to capital in the Indian corporate sector and that was an important indicator for an appropriate discount rate, not—it isn't that the appropriate discount rate should be exactly what I was measuring. But that the thing I was measuring should be an important input into the choice of the appropriate discount rate for cost-benefit analysis. So in any case, at a certain point in time they said what about our work on evaluations of highway investments and so on? And I said well, send me the annual reports of your ministry of transport or I forget what the entity was, but the entity that's in charge of highways. Send me its annual reports for the last few years and any other documents that you think are relevant.

So we get these annual reports, and each annual report starts the same way. It starts, on page one it would have the countries of the world listed by number of miles of paved road per capita, let's say. And there you would have Canada, Australia, United States, Brazil, all these big countries with wide expanses, they would have lots of roads per capita. But at the bottom of this listing was India. Then they would have miles of paved road per area, and there you'd have Luxembourg [laughter] Holland and Belgium, densely populated countries, and at the bottom low down would be Australia and Canada probably, but also India. India was at the bottom in both of these

listings. And the message that you were supposed to draw from this was, look at us, see how terrible we are in the international area in this business of paved roads? Please give us more budget for paving more roads, okay? And so what was my response? Let us please make a table of number of miles of paved road per motor vehicle. So they made the table and guess what? India right on top.

02-02:49:05

Harberger:

And what was the message? Well, since the main justification for the paving of roads is to have more vehicles move on them that when you have few vehicles you don't need so many roads [laughter]. And it was just a sort of turning the tables on their hype, which it was, nothing but pure hype in the first place. And this showed by a more relevant criterion that their hype didn't really get very far.

02-02:49:44

Burnett:

Well, this is, I guess that's the first— because the Chile project was education—so is this then the first international project-evaluation project?

02-02:50:01

Harberger:

Well, this wasn't the project evaluation. I was working in the field of project evaluation, but I wasn't taking a specific project and evaluating it, which is what we teach people how to do in project evaluation. But I certainly worked the corners of that field both in the measurement of the returns and in the studies of economic growth and in this stuff about the automobiles—pardon me, about the—

02-02:50:43

Burnett:

Roads.

02-02:50:43

Harberger:

—highways. And by the way, an observation, we traveled in India in enormous amount. We put 20,000 miles on our car in nine months. And the one trip we went east, to the Bombay area, Poona and Bombay, Ajanta and Allora caves, Ahmedabad, Jaipur and back to Delhi. Then on another trip we went to Benares and to Khajuraho and Cuttack and then to Calcutta and then back. And then on another trip, a vacation trip, we went to Kashmir and stayed on a house boat with Mr. Butts. On a houseboat on a lake, just beautiful. And Kashmir was comparatively quiet—

02-02:51:59

Burnett:

Yes. Right.

02-02:52:01

Harberger:

—at that time and it was really good. I went to a conference in Hyderabad and oh we went to—we had a student at Chicago, a student of Ted's called Raj Krishna who later became a member of the Indian Planning Commission himself and who was quite an important figure. Well, he took us one Sunday to the Kumbh Mela, I don't know if you've ever heard of that. This is a Hindu

festival that takes place once every 12 years. And it was held in the city of Hardwar on the Ganges River which is the holy river. And it was just a huge multitude of people coming and there were funeral pyres on the Ghats, all along the river. And people were celebrating this and that and there were holy men dressed in orange and saffron. But there was one special group of holy men that took our attention, which were guys that were completely nude as far as I can remember. Maybe not exact. But they were covered in ashes except for their private parts which were painted in scarlet [laughter]. And they were going around. These were holy men walking around nude. India was just— talk about culture shock [laughter]! And this attracted our attention but it didn't seem to attract terrible special attention from anybody else around. [laughter]

02-02:54:10

Burnett:

What a great opportunity, I mean once every 12 years that happens for you to be there at that moment.

02-02:54:13

Harberger:

Yes, to be taken to it. If we had gone as a tourist it would have been totally different I think but with Raj Krishna as our guide, it was just wonderful.

02-02:54:26

Burnett:

Oh, that is fantastic. So you're there for that year. You traveled by car. What did you use for a car?

02-02:54:37

Harberger:

Well, the MIT project, the day we arrived we were taken to our apartment which had already been chosen for us by the MIT project which was about a 3,000 square foot apartment with a beautiful balcony overlooking a golf course and with a huge living room, dining room, master bedroom and all of that. And then we had a cook, who was Raju and we had a sweeper who was Chidda, and we had an ayah to watch the baby, and we had a driver, Mangal Sen. And Matin was the ayah. She came from Burma. So we had all of that and we had a Hindustan ambassador car put at our disposal which Mangal Sen drove. But he didn't drive it home at night. He came on his bicycle and he drove the car. And then when he went home I had the car to drive myself in the evening to go to anywhere I wanted, to visit somebody or to go to the movies or whatever. So it was Mangal Sen driving this car that took us through this 20,000 miles. But if I learned about India from any place or anybody nothing matches what I learned from Mangal Sen. This was true India. His favorite Indian god was Hanuman, the monkey god who built the bridge to Sri Lanka to save Rama and all of that. So whenever he talked about Hanuman his whole spirit rose up and you could see the enthusiasm that was in his mind.

But then we were driving I remember one time and a jackal crossed the road from right to left and he started to shake. This was a bad omen. This is very bad and he started to sweat and just going like this and like this [looking side

to side] and then this would go on for maybe an hour or something. Then all of a sudden, another jackal crosses the road from left to right. That cancels the first one, and he is happy again. [laughter]

02-02:57:40

Harberger:

He was a middle-class Indian, okay, but he came one time and he had trouble because a rat had bitten his son in the ear.

02-02:57:57

Burnett:

Oh, my goodness.

02-02:57:59

Harberger:

And he had a wage that was four times the wage of a construction worker or something like that and still this was his level. But later we went to visit him; we got in touch with him when we went back in '72 and '73 or one of the two.

02-02:58:22

Burnett:

Ten years.

02-02:58:23

Harberger:

Or whatever it was. And he took us to his daughter's house and his daughter was married to a medical doctor and they had a nice apartment. They had their own car and so on. And it was a very rewarding kind of thing to see that for this driver who had that experience, that somehow the next generation was coming up and progress was really being made.

02-02:58:57

Burnett:

There was upward—you encountered upward mobility—

02-02:59:01

Harberger:

Yeah, absolutely.

02-02:59:02

Burnett:

—by witnessing the transformation of his fortune. That's a wonderful—you got all of these human perspectives on your experience there. And it's tempting to think about how that impacted your thinking, but maybe that will emerge as we talk over time.

So I don't know if we can talk a little bit about a couple of things that happen. I don't know what you remember about this but there was something, a publication of the Government Printing Office in 1957, *Federal Expenditure Policy for Economic Growth and Stability*, and I think you wrote a piece called "The Interest Rate and Cost-Benefit Analysis."

02-02:59:57

Harberger:

Yeah, that was one. Probably my first foot in the water on project evaluation directly.

02-03:00:07

Burnett:

And I'm wondering if we can trace some kind of trajectory just for those first few years about how you developed your expertise in cost-benefit analysis. What were the problems or questions that were emerging?

02-03:00:27

Harberger:

Well, let's go back. This triangle analysis, okay? I am teaching my first course in price theory at Johns Hopkins, not yet with my PhD. My PhD was coming in June. And I was teaching in October. And what do I have there? I have a diagram analyzing the different plans for price supports in the United States. We had Secretary of Agriculture Brannan in the Truman administration. And he had the Brannan Plan which was a two-price policy that the government would buy all the wheat at the support price but it would sell the wheat for whatever the market would bear so it didn't accumulate these huge stocks. They were worried they were accumulating wheat. They were filling all the empty Liberty ships—

02-03:01:37

Burnett:

That's right.

02-03:01:37

Harberger:

—[laughter] but the rats were eating the wheat, you see. So this was the Brannan Plan story and then the other story was acreage restriction. And acreage restriction would hold the quantity back so the government didn't have to buy it, but it would have the inefficiency that since you were restricting the land factor, but not the other factors of production you would use too much of the others relative to land therefore [resulting in] a marginal inefficiency of production. So you had the triangle of inefficiency of consumption that you—the marginal cost of those last things that the government was buying was all the way up to the support price, but the marginal benefit was down to the market price that it would bear, you see, whereas, on the other side you had this inefficiency of production coming from the fact that you were using too little land and too much of other factors of production. These were triangles, complicated triangles, and this was before I even had my PhD. [laughter] And I've used that example in courses in price theory all the way, because it's a very instructive example. It conveys a lot of economics in a few words, so to speak. So there is that beginning to the process.

And I worked with any number of examples with respect to different taxes, different subsidy schemes, other government policies all through these years. Now where were we going from there?

02-03:03:38

Burnett:

Well, so this was one more instance of that kind of research in 1957 that you were doing, *The Federal Expenditure Policy for Economic Growth and Stability*. I'm interested in how this gets received and how this becomes part

of the public finance community's interests and the international development community as well. Does it take time for that to—

02-03:04:25

Harberger:

Oh, it definitely takes time and let's say, 1964 was a quite important year. And I think it was then that I wrote the paper "Taxation, Resource Allocation, and Welfare." It's in a Brookings volume. So what I was doing in this paper was showing analysis of taxation and subsidies, that kind of thing, in a general-equilibrium setting where you have multiple sectors and commodities and so, if you put just a tax on one thing, you get a triangle. Okay. But suppose you already have a triangle, now you put a tax on another thing what happens? Well, if that other thing is a substitute for this first thing, the newly taxed item's demand is going to be constricted, and demand for the already-taxed substitute is now going to expand. So you get a benefit where marginal benefit paid by consumers is higher than marginal cost borne by suppliers. On the substitute item this generates a rectangle of benefit. So you have this complicated story. You have three or four sectors and you have the first tax generating one triangle and that's all. Then the second one you put a tax and you have one triangle and one rectangle. Then you put a third tax and you have one triangle and two rectangles [laughter]. And with a fourth tax you get one triangle and three rectangles. This can go on for as many sectors as you have, and you see, the thing gets quite complicated.

And yet, in the end you can re-*phrase* this question. Instead of thinking about we now have four taxes on four different sectors let's say, and we have looked at this as you put a tax first on one and then you put a second, then you put a third, then you put a fourth. But you can think of this a different way. Let's put them all on together. And we're going to start with just a quarter of the end tax on each one and then we're going to take it to a half and then we're going to take it to three quarters, then finally we're going to take it to four quarters so we get the whole thing. Well, this way you're generating four triangles, and these four triangles encompass all of the end result that you get when you do them in sequence and get triangles—we had four triangles and one plus two plus three, we get six rectangles. So instead of having four triangles and six rectangles—yeah, now we only have four triangles, but four different triangles from the other ones. Well, this is all in this Brookings paper which even today is widely, widely used and cited as a didactic paper in this area. It's really not creating new economics. What it's doing is putting in an EC1 or EC101 setting something that previously was only in highly mathematical graduate courses in a different language, so to speak, that this general-equilibrium stuff that we get to with this scheme was there in Slutsky's work and in Hotelling's work long before my time, but all highly mathematical and sort of arcane. And this '64 paper made it readily accessible at a low level of teaching and is widely used.

02-03:09:28

Burnett:

That's the National Bureau of Economic Research and the Brookings Institution: *The Role of Direct and Indirect Taxes in the Federal Reserve System*. So it alerts people to some of the challenges. This is something that I read in your work, that you take common assumptions and you poke at them and you examine the degree to which they're true. So in the case of the corporation income tax, the assumption was that corporations bear the burden of that tax. And one of the things that you explore in a number of papers—

02-03:10:17

Harberger:

Well, now that, you see, to me, how could a whole goddamn profession be thinking that corporations bear the burden of the corporation tax or shareholders bear the burden of corporation tax when you have a capital market? I mean, it's not going to be that everybody gets six percent before you have a corporation income tax. Then when you get a corporation income tax everybody else gets six percent but corporate shares only pay three. Who's going to hold corporate shares? [laughter] So the idea that you're going to come to a new equilibrium where, whatever it is that happens, all of capital is bearing, and in a broader sense over the world capital market, you see, that somehow wasn't in the picture in the analysis of incidence. It seems so crazy, and my '62 paper built on the idea that we had these factors, capital and labor, and we have a corporate sector and we have a non-corporate sector and then we put a tax on capital in the corporate sector, and we see how it shuttles its way around. And it turns out that, depending on the parameters of the system, the incidence can go quite a distance. Capital can more than bear the full burden of the tax and capital can less than bear the full burden of the tax. And in very extreme cases, *labor* can bear the full burden of the tax. But mostly its capital bearing something between let's say a third of the burden and one and a half times the burden of the tax. And that paper made quite a splash and I think nowadays too much of a splash, because that was before, I mean, first of all, I can excuse myself that the literature on this kind of subject was very definitely in that vein, an economy with capital and labor and you created equilibrium. That's what we call a closed economy, not introducing international trade. But it turns out when you introduce international trade, the problem stands on its head, because capital is so mobile internationally and labor is so immobile internationally that you put a tax on capital in one country but not elsewhere and capital is going to do what? Move from here to elsewhere [laughter], up to where? Up to when the capital gets the same rate of return in both places, right? So if capital bears a burden it's going to be borne worldwide but labor is going to bear the burden right here. And *even* when the capital is bearing the full burden worldwide, for labor here, that wage has to go down because the price of the product is set in the world market. The price isn't going to go up. So the end result of the story is that you have similar variation of incidence, but its labor that can bear [laughter] a third or a half of the burden of the tax or it can bear the full burden or it can bear twice the full burden [laughter] of the tax.

02-03:14:18

Harberger:

And in much later work, I show that you can have capital worldwide bearing the full burden of the tax and labor here bearing more than the full burden of the tax. How can that happen? Because there are other beneficiaries. When capital worldwide gets a lower rate of return, *labor* in the rest of the world is gaining that, you see. And when labor here has its wage being cut by half, the thing is that the wage of labor can't be cut by half in the corporate sector and not elsewhere. We have a labor market. So if wage has to go down in the corporate sector, it has to go down in other sectors also. Then, the amount by which wages go down elsewhere redounds to the benefit of consumers of those other products. So you have beneficiaries other than the government which enables us to have burden bearers having burdens which add up to considerably more than the full burden of the tax.

02-03:15:38

Burnett:

A kind of burden multiplier.

02-03:15:38

Harberger:

Yeah, [laughter] right. Right.

02-03:15:39

Burnett:

[laughter]

02-03:15:41

Harberger:

So anyway this is a little bit the story of corporate income taxation.

02-03:15:46

Burnett:

I guess then you started this off by asking why the economics profession ignored that, or didn't think about it. But maybe it's a product of its time in that, if you're talking about these kinds of quasi-Keynesian systems, right, so that Keynesian economics is born in a time when global trade has withered and there are these national economies. You have wartime economies, these are national, somewhat closed economies. And the United States after World War II didn't have international competition until the end of the 1950s.

02-03:16:31

Harberger:

Well, be careful about that.

02-03:16:31

Burnett:

Okay.

02-03:16:31

Harberger:

I mean one of our main—we are the world's biggest agricultural exporter. And that was always a world market. And primary products that we're importing, that's also a world market. That's, and I wouldn't even think of saying we were a partially closed economy or something like that—

02-03:16:57

Burnett:

[laughter]

- 02-03:16:57
Harberger: —at *any* recent time.
- 02-03:17:01
Burnett: But relative to—
- 02-03:17:02
Harberger: now, with the Smoot-Hawley Tariff maybe we got [laughter]—
- 02-03:17:04
Burnett: [laughter] But I would say that right after World War II the United States controlled half the world's trade, right and—
- 02-03:17:14
Harberger: Well, it produced half the world's GDP, yeah.
- 02-03:17:17
Burnett: Yeah, and it's true. It's definitely true that there was an international market for commodities but compared to today, I mean trade as a percentage of GDP did not reach 1913 levels until the 1980s.
- 02-03:17:38
Harberger: That's correct, yeah.
- 02-03:17:38
Burnett: There's—it was relatively more closed and perhaps because—
- 02-03:17:47
Harberger: Yeah, but...
- 02-03:17:47
Burnett: I shouldn't have used "closed?" No?
- 02-03:17:49
Harberger: I don't. I don't...
- 02-03:17:50
Burnett: Yeah?
- 02-03:17:50
Harberger: I don't react well there.
- 02-03:17:52
Burnett: Okay, fair enough [laughter].
- 02-03:17:52
Harberger: The thing is that if prices are determined in world markets you have these prices and then you're going to have in each country an amount that at those prices will be supplied and you have another amount which at those prices will be demanded. Where the amount supplied exceeds the amount demanded that country is an exporter of the product. And vice versa, if the amount demanded exceeds the amount supplied it's an importer. So you can have a

fully open economy with domestic demand and supply closely matched in quite a lot of sectors, you see, that it doesn't stop it from being open. The openness is determined by the fact that it cannot have a price far different from the world price.

02-03:18:54

Burnett:

At the end of the fifties and the early sixties you are writing about these effects that people had ignored, I mean, in a sense you had said earlier as well that some of this is 19th-century stuff, right. And you're reminding people about this and measuring it and showing the ways in which the economy is this open porous system with these interdependent elements to them. And so that becomes part of your real influence in economics, generally.

02-03:19:48

Harberger:

Yeah, I think that in public finance, I mean these two papers that we have just recently talked about the "Taxation, Resource Allocation, and Welfare" and the "Corporation Income Tax" paper they were absolutely among the big hits of my career [laughter].

02-03:20:19

Burnett:

Some of your greatest hits, yeah [laughter].

02-03:20:21

Harberger:

Now, did we talk about the measurement of waste? I think we talked about this off camera.

02-03:20:27

Burnett:

A little bit and it's your 1964 paper as well.

02-03:20:31

Harberger:

Where? Did I talk on camera about Samuelson and Koopmans in "Measurement of Waste" paper?

02-03:20:38

Burnett:

I think a little bit. I don't have the transcript yet [laughter]. I think to my recollection you talked a little bit about it. But this is what historian James Hines said about this paper. He says that the triangles in this paper make possible the measurement of the real cost of public expenditure and taxation. That this is a really signature paper.

02-03:21:05

Harberger:

Which paper is he talking about?

02-03:21:08

Burnett:

He's talking about the "Measurement of Waste" paper—

02-03:21:09

Harberger:

That's interesting.

02-03:21:11

Burnett:

—of '64.

02-03:21:12

Harberger:

Interesting that he should say that. [AH note: I actually do measurement in lots of other papers, whereas this particular one is closer to the stratosphere than the others.]

02-03:21:18

Burnett:

So this is '64, but you, I mean going back through your—you wrote in the *American Economic Review* in '59 “Using the Resources at Hand More Efficiently” about the effects of taxation in Chile. And I was wondering if that—it’s about comparing price distortions versus quantity distortions. And you’re comparing quotas versus taxation. But I wondered if these are the forerunners of your work in —?

02-03:21:57

Harberger:

Well, all of this is all part of one big ball of wax. Applied welfare economics is applied welfare economics and this is the world in which I have been working all these years. In some sense, my personality is such that I am not that scientist who thinks about something and then says, I have my life planned and I am going to work on this thing and plow this furrow and all of that all the way. This is nothing to do with Harberger, and there’s hardly a thing I ever wrote that was not written for a deadline. Unless I have a deadline it’s not going to happen *today* [laughter].

02-03:23:00

Burnett:

Okay.

02-03:23:04

Harberger:

The story of my life, in a sense, is that if you’re a juggler and you’re juggling seven balls in the air your rule is a very simple one. You catch the one that’s closest to the ground [laughter]. There’s no issue about that. Okay.

02-03:23:22

Burnett:

Okay.

02-03:23:22

Harberger:

So if you have seven tasks facing you at a given time, which is the one you’re going to have to grab is the one that’s going to be due next week. You can’t do the one that’s going to be due next year or anything like that. The only reason why there is coherency in what I have done is because of the jobs that A) I was asked to do, and B) accepted to do [laughter]. So I was asked sometimes to do things that I just turned down. I was asked by the State Department to help them negotiate a treaty with India about intellectual property to save American intellectual property from being impinged in India. And I said to myself, Harberger, steer clear of that one. And what was my image? My image was well, why then India will say well, why don’t we do like China in Africa and we’re going to bid for construction projects in the United States where we’ll bring the capital and we will bring the labor. And we will build your buildings with Indian labor and then take the Indian labor

back home. What's wrong with that? You see and I said "oh, I'm not going to get mixed up in that fight" [laughter].

02-03:24:54

Burnett: Yeah [laughter].

02-03:25:04

Harberger: I'd rather stick to things that I feel at home with, and feel that I can positively contribute, however little, and this is how a body of work developed that really does have a lot of coherency.

02-03:25:13

Burnett: It does, yeah.

02-03:25:14

Harberger: It's not just scatterbrained or anything like that.

02-03:25:16

Burnett: Yeah, in the Chile paper in "Using the Resources at Hand More Efficiently" in the *American Economic Review* in '59 you're talking about — these are triangles and the effect of a quota versus the effect of taxation. And but what you're actually making explicit here is the costs of protectionism—

02-03:24:41

Harberger: Exactly.

02-03:25:41

Burnett: Right?

02-03:25:43

Harberger: Right.

02-03:25:43

Burnett: And moreover, you say which is absolutely fascinating "getting rid of distortions will help but will not provide — " and I think you used the phrase — "takeoff."

02-03:25:55

Harberger: Right.

02-03:25:55

Burnett: "Will not provide the takeoff countries are hoping." And so this is a—you're engaging in a debate about big-push development economics — the advocates [who argue that] a certain amount of capital investment will develop this self-sustaining [economic take-off]. That's the Rostow/ Center for International Studies line. And you're pushing it more in the direction that technical advance is the key. And it ends with a question, "What kind of policies will create a kind of adaptive or acquisitive culture?" How can you provide the right policy incentives to—

- 02-03:26:41
Harberger: And that's one of the great advantages of openness.
- 02-03:26:43
Burnett: Right.
- 02-03:26:45
Harberger: Absolutely.
- 02-03:26:47
Burnett: So that seems to be—and so that the work on the triangles is being folded into your writings on—
- 02-03:26:59
Harberger: No, no. It goes like this you see, that the analysis of triangles is what we call comparative statics. That you take a picture of the economy at one time. Well, we have this allocation of these resources. Now let's make a hypothetical and re-shift these resources so we use more resources in industries that have been excessively restricted and less resources in industries that have been excessively favored. And in doing so, we have a more efficient economy. That's where the gain is 15 percent. So 15 percent is 15 percent. Now seven percent growth doubles in 10 years, okay. Four percent growth doubles in 18 years. So the—if you can get this growth process moving, you're way ahead of this 15 percent business, you see. And what I was trying to say is that, yes, you should have a more efficient economy, and using the resources more efficiently will get you more, and it's definitely worth your while to get that gain. No question about it. But if you think of another margin, the margin of economic growth, if you can do something that will make the natural forces of growth work more effectively in your economy, you're likely to be way better off in terms of total present value of what you're doing. And that was I think the message of that paper.
- 02-03:29:06
Burnett: So there's all of that work being done in that area, but you're also thinking about Latin America, right, you're also thinking about how you can harness what's going on at Chicago. So can you talk about, I don't know if we're ready to talk about this, can you talk about the foundation of the Center for Latin American Economic Studies?
- 02-03:29:45
Harberger: Yes.
- 02-03:29:48
Burnett: That's 1965, isn't it?
- 02-03:29:51
Harberger: Does it come that early?
- 02-03:29:52
Burnett: I think so.

02-03:30:00

Harberger:

I'll tell you what happened. We talked about the Chile project and I mentioned also that Albion Patterson had moved to Argentina and that we had started an Argentine project in the University of Cuyo in Mendoza in 1962 which went until 1967. So it had five years where the Chile project had had five plus three. But otherwise we were trying to use all the lessons of experience that we had from the Chilean project for this Argentine project. And we were very fortunate that everybody was happy that we could, you see I mentioned the fact that to get staff to be living in Chile was a hard thing, you see. We knew that. Well, to get people to be living in Argentina we had one American and two Chileans [laughter]. And the Chileans came from the Catholic University and the Catholic University was a co-signer of the tripartite—now—university contract arrangement. And this worked perfectly and we had Ernesto Fontaine and Raul Yver as resident Chileans in Argentina. Both absolutely first class and far superior to what we would be able to get having equivalent numbers of staff American. We had very good American staff there. We had Larry Sjaastad who became my forever sidekick in Latin America work in Chicago. And then we had Richard Blackhurst who later went to the World Trade Organization I think in Geneva. And became a very significant factotum there as far as economic matters were concerned [laughter].

02-03:32:16

Burnett:

[laughter]

02-03:32:18

Harberger:

But anyway the Argentine project went on like that. So both of these were financed by USAID [United States Agency for International Development] and [H.] Gregg Lewis was the sort of book manager of these projects, that he kept the books and did some—a lot of the executive arrangement and that level. And he and I were both incredibly frustrated by the stupid bureaucracy, the hoops we had to jump through in order to release—

02-03:33:08

Burnett:

In multiple countries [laughter].

02-03:33:10

Harberger:

—money to do this and to justify that. And here we got into the Chile project by act of God, so to speak, in a meeting with Ted, and Patterson, and so on. We got into the Argentine project because Patterson moved over there. And that was part of the motivation. But after that we weren't about to go looking for another project; it wasn't that we were in the project business that way. And what had happened was, and this always happens, when we do something with Chile like that, a bunch of Chileans come study and then they go back and teach in these Chilean universities and guess what? Their students want to come to you. And then this happened with Argentina and so on. And we have a whole flood Chilean students. We have a whole flood of Argentine students coming, paying money from the Ford Foundation, from AID itself, from their

Central Bank, from anything. They're coming anyway. And we don't have any bureaucracy at all to worry about. And the biggest benefit that we've ever seen from the Chile project is from the training that we're doing here in Chicago. So we're getting all of that benefit just from people here in Chicago.

So what had already happened to a degree at the time when this Ford Foundation thing came is that we were getting Brazilians as well. And so anyway I got to talking with Harry Wilhelm. Harry was a very admirable Ford Foundation person and he happened to be in charge of Latin America at this moment and it was he who then went to India and invited me to India in the seventies. But I said "Harry, just give us money to play with in Chicago, to have a seminar, to finance some dissertations, to invite speakers, to do this, to do that, and I am notoriously tight with the dollar and I always make money last much longer than people give it for. That's the anti-normal-bureaucrat way of doing things but I can't help myself. It's just the way it is. But anyway, he gave us substantial financing and it lasted a long time and kept our seminar going, met all needs that were needed as they came along and eventually I had enough money leftover that it went for half again as many years as the money was originally given for. So everything worked.

02-03:36:45

Burnett:

That's brilliant. And so as you said, originally this is to help these other countries, but you're also getting this stimulus from this talent coming from those countries as well.

02-03:36:59

Harberger:

Well, I think it's the other way around, that we weren't out there helping the other country; we were out there selling good economics all the time. I mean it wasn't our love for Chile that brought us to Chile nor was it our love for Argentina; it was an opportunity to learn in the first place but it was also an opportunity to sell our product—what we thought was good economics. And then when the opportunity came for us to be having as much or more of an impact on Latin America without all the difficulties, bureaucratic difficulties and so on that we had with the USAID, we were very happy to shift gears in that way. And then during this period we usually had about at least a quarter of our graduate student body was Latin American and so we never lacked for Latin American students, and if we ever had a problem it would be with other colleagues thinking we had kind of too many Latinos but they never thought that because they were so good! And why they were so good was that we—we were veterans in Latin America, I mean we knew Chile, we knew Argentina, I worked with the Ford Foundation. I was the Ford Foundation economic adviser in Brazil for about 10 years, going every year two or three times to Brazil to help them in choosing what they would do in economics in Brazil. So I knew about Brazil, I knew about Panama, Costa Rica, Colombia, all these places. So the idea was that we get students from any of these places and we could train them the same way that we trained the Chileans in the first place and they could go back to their countries and see what they could do in

implementing sensible economics in those countries. And many of them went back to several different countries and did very good things. I don't know of any case where they did bad things.

02-03:39:50

Burnett: Economically.

02-03:39:51

Harberger: I mean implemented bad economics instead of good economics. And so I think that doing the operation after the Chilean/ Argentinian projects through the Center for Latin American Economic Studies I think was just ideal from our point of view. We got the training done. And we had a minimum of interference. We could do it our way. It was just great.

02-03:40:26

Burnett: Well, let's, I want to leave aside what happens in Chile for later because we're going to talk about that another time.

02-03:40:34

Harberger: That'll come later, right?

02-03:40:36

Burnett: Yeah. But I'm curious if your students with whom you remain close, did they ever talk to you about the training that they got in "good economics" as you put it, and how that helped them to argue in a field in which there were other visions of what "good economics" were, right? Milton Friedman in the United States argued for what he saw as good economics against a tide that was very different, right, a very, very contrary view of how things should be done it seemed, right?

02-03:41:19

Harberger: Well, I mean, these things can be exaggerated, I mean tempests in teapots do indeed happen, and in a very broad sense, I mean Ken Arrow is almost an opposite of Milton Friedman, okay. But if you're a mathematical economist and say, who are the great heroes of market economics and competitive economics? Arrow and Debreu, okay? They found the path to competitive equilibrium [laughter] by complicated mathematics and Milton followed a path to competitive equilibrium in a more intuitive and simple way, but they both get there.

Now if you say, well, how much government policy should be involved in education? How much government should be here? Well, can government be wise? Well, "can government be wise," is not to me a piece of economic theory so to speak or of economic science. A government can be wise and it can be dumb and we have examples of both. I mean, look at Singapore and look at Idi Amin [laughter].

02-03:42:37

Burnett:

Right. Absolutely [laughter]. But your students who then had to go out and in a sense argue in policy domains—

02-03:42:52

Harberger:

Yeah, there we go. Well, I mean, how can one say? It's part of my credo that we economists as a profession have a responsibility to bring to the table, at which policies are decided, to bring the messages of our discipline. And we have a right to sit at that table and if we are denied that right that's very bad. But if we get to the table and we start talking about everybody else's expertise as if it were our own, I think we are overreaching. I think it's our main business to bring the messages of economic science and that when it comes to matters of broad social policy and things like that, we should not claim to have a voice that is any greater than that of the others. And if we're pressing our expertise in economics, we should be super-modest in the other areas rather than the other way around, you see? That's my line.

In the process of this, I believe that in order for us to have influence in those discussions, we absolutely have to talk a language that these other guys can understand. And we cannot think that they're all graduates of Harvard, and MIT, and Stanford. They are people, some of whom have never had a course in economics, and some may have had one or two, and very few will have had more. So we have to be able to make them understand what we're talking about.

Okay. I try to teach economics in that way and I try to write economics in that way except for maybe the "Measurement of Waste" and a few other things, but—on the whole I think that people agree that that's the way it works and I think that when my students think after they've been in government and so on that yes, we learned a lot from Harberger, I think half of what they learned was [laughter] this: that is to say, because I was putting arguments to the class in ways that didn't try to show off how complicated they were but tried to convey the sense of why you're doing what you're doing, so to speak. That is critically important in getting anything approved in a governmental setting, absolutely.

02-03:46:06

Burnett:

You want to maximize understanding.

02-03:46:07

Harberger:

Yeah.

02-03:46:09

Burnett:

Absolutely. If this work is considered to be development work, it stands in marked contrast I think to work in other social sciences that were charged with development, or took as their mission development. So the political development folks, right, so Lucian Pye and Gabriel Almond, this idea of a total transformation of society. At the beginning of the 1960s, there are these

important discourses out there for how you need to *develop* a nation or *develop* a people and it's this call for a complete—

02-03:46:53

Harberger: Nation building.

02-03:46:54

Burnett: Nation building, right? This stuff dies hard. It really does, and this work is different and there are different kinds of expectations and perhaps it is rooted in this understanding that these things unfold over time—

02-03:47:10

Harberger: Well I think part of is, one thing that is sort of neat in economics is that there's just a plethora of problems. The worse the situation of the economy, the greater the number of problems like this where an economist can go there and say I can fix this thing in the marketing of cotton, you see? Or I can fix this thing in the choice of electricity generating capacity. Or I can fix this thing in the organization of our ports, you see. That we can kind of grab a hold of a little problem and show how improvement can be made by fixing that problem and there are a lot of places we can do this. And we really don't have to have this *big, overarching*, super-, to me, egotistical [laughter], way of looking at things. I much prefer to think of myself as a carpenter than as a kind of dictator [laughter].

02-03:48:37

Burnett: Well, with that, we should probably pick up next time.

02-03:48:40

Harberger: Okay [laughter].

[End of Interview]

Interview 3: November 30, 2015

Session 3A, Morning

03-00:00:00

Burnett: This is Paul Burnett interviewing Dr. Arnold Harberger for the Economist Life Stories Project with the UC Berkeley Oral History Center and the Becker Friedman Institute at the University of Chicago. And this is our third full day and we're here in Chatsworth, California. So, Dr. Harberger, we were last talking about your wedding in England and your honeymoon and your year with the Indian Planning Commission, 1961 to '62. And then I think you went to Chile for three months as part of—

03-00:00:50

Harberger: Went to Chile for three months in the fall. We had our honeymoon, and then spent one term in Cambridge. Then we spent the summer traveling Europe and after that went to Chile for three months and finally back to Chicago, just before Christmas.

03-00:01:12

Burnett: Okay. So you're back to Chicago for the fall semester of—

03-00:01:15

Harberger: No, for the winter.

03-00:01:18

Burnett: For the winter quarter. Okay.

03-00:01:19

Harberger: I was in Chile in the fall quarter of 1958.

03-00:01:32

Burnett: So a number of things happened at the end of the fifties and the early sixties at the University of Chicago and one of the things is that Theodore Schultz, who had been the chair of the department from 1945 or six, there are different reports about that, 1945/6 to 1961.

03-00:02:04

Harberger: That sounds right.

03-00:02:05

Burnett: Yeah. So can you talk about his stepping down? Did that happen while you were away?

03-00:02:14

Harberger: Oh, I have no idea. I don't have any inside information, so to speak, about his stepping down. But he was succeeded by Al Rees, and Al Rees was chairman from '61, starting in summer or fall of '61, until summer of '64, which is when I took over.

03-00:02:49

Burnett:

Right, right. And can you talk a little bit about that succession? How did that happen? How did you become chair of the department?

03-00:03:05

Harberger:

I haven't got the slightest idea. There were several elements here. Number one, in most universities the chairmanship is something that people hate to do. And there is a term, usually three years, and somebody does their three years and then says, "I am out of here," and usually they go on leave to some other place in order to emphasize that they are out of here. Well, certainly the tradition at Chicago is not that way. And the amazing thing is that from the time when T.W. [Schultz] took over in '44, '45, whenever it was, and something in the order of '85, apart from Al Rees's three years there were only three chairmen. It was Schultz and me and D. Gale. That was, I think, part of the Chicago tradition. Somehow we somehow viewed ourselves as conservators of the Chicago spirit or the Chicago personality. And I think the system worked pretty well in that respect. Obviously we're different people and we had somewhat different styles. I'd say of the three, T.W. was the most entrepreneurial. He put drive into the job, so to speak. And D. Gale and I, in a way, you might say that Schultz had something more to create. And we had something more to preserve. [laughter]

03-00:06:01

Burnett:

Right. That makes sense. It does.

03-00:06:04

Harberger:

But anyway, that was that story. I honestly don't know the circumstances of Al Rees's termination, but I believe that he was moving to Princeton. At that time he had an offer from Princeton. He took the offer and that was that.

03-00:06:26

Burnett:

Right, right. It sounds like there's continuity both in the leadership of the department and also the sense in which students remain at Chicago. Zvi Griliches was a student and then he became a professor there. There are those who study, then come back. There's a long list of those people, right? Which is not all that common. Typically the story is that you study at as many different places as you can and then you go to another place. There's no return. No? There's no rule about that?

03-00:07:10

Harberger:

Well, I think it's much more luck of the draw than that. But I would say this. Chicago has this kind of unique personality about it, more so than other leading departments. The idea is that you're supposed to think big, that having an article in a refereed journal means nothing. Your aim is for some kind of leadership in some branch of the profession. That's a tremendously attractive thing to people, especially when they've been there before. See, the person on the outside who studied at Stanford and was teaching at Harvard or something like that. He doesn't have the feel of Chicago, that growing power. So that may help explain how it is that people like George Stigler came back, Gary

Becker came back, so on and so on. Bob Lucas came back. I came back. [laughter] So it's a long list. Telser came back. In a way Nerlove came back, even though Nerlove did his PhD at Hopkins, he wrote his thesis at Chicago. [laughter]

03-00:08:56

Burnett: Right. [laughter] He was at Hopkins when you were teaching.

03-00:09:03

Harberger: Yes, he was a student of mine—

03-00:09:05

Burnett: He was a student of yours. Okay.

03-00:09:05

Harberger: —at Hopkins, correct. But his reason for coming to Chicago was he was very close with his family. His father was on the business school faculty and they had a nice apartment. So he was staying there writing his thesis. I don't know what the circumstances were that I invited him to join but it's perfectly reasonable. Here he was writing his thesis. I have this workshop. It's a very interesting thing. Very linked to Chicago through agricultural supply and the work of T.W. and D. Gale. So everything sort of fit very nicely for him to be doing his thesis in our workshop and it worked fine.

03-00:10:05

Burnett: Yeah, absolutely. We can talk, I suppose, about the Rees years, between '61 and '64, and maybe a little bit before that, as well. This is a time when you've come off of India and it's in a sense your first kind of application of your project evaluation ideas. And you're also doing work in taxation. The incidence paper comes out in '62. Presumably you had written it and submitted it before you left.

03-00:10:57

Harberger: Yeah, the incidence paper. This is an interesting story, see. I said before I think that I always write for deadlines.

03-00:11:11

Burnett: Yes.

03-00:11:12

Harberger: And this incidence paper was written for a conference in Germany, in Berlin if I'm not mistaken. It's going to be published in Europe in some obscure conference volume and here this is something that I knew was a major part of my effort. And somehow I convinced these guys to let me submit it to the *JPE* [*Journal of Political Economy*] [laughter] for publication. But probably in my whole life I've only submitted five or six or seven things for publication that weren't asked for in one way or another. And that's just my own laziness, my own tendency to always make it better before I submit it. The deadline has a very definitive aspect to it and so you have to wrap it up somehow and tie a ribbon around it. I don't have a full explanation of that aspect of my work. But

it is certainly true that I wasn't pushing to publish, if you know what I mean. And that is very clear. However ideas developed, they just developed over time. Why is there any unity in the work, so to speak? It's a little bit hard to explain but not too hard. My public finance responsibilities in Chicago, that was a big challenge when I first got there. And so that gave rise to all of these separate papers that got published in that area. And then the same thing happened with project evaluation. Applied welfare economics in some sense is an umbrella covering much of the taxation stuff and virtually all of the project evaluation stuff.

03-00:13:41

Burnett:

Well, from a birds-eye historical view, something appears to have stuck in your intellectual craw with respect to taxation, right? So there were, if I'm not mistaken, some reigning assumptions or perhaps under-examined assumptions about the effects of taxation on corporations.

03-00:14:09

Harberger:

Well, the corporation income tax thing, it came very naturally to me because my whole background was in international trade. And in international trade we think of a country having a comparative advantage in something and usually that something is where it has an abundant factor of production. And the other country — and much of the trade literature is crazy, just has two countries instead of one country and the rest of the world. But that's the way the trade literature went, two countries with different characteristics. Okay. I get to the incidence of a corporation tax. I have the corporate sector, the non-corporate sector, different factor proportions. You see, the shift from trade to that was very simple. But the interesting thing is that paper made a very big splash and nobody, including myself, pushed the question that this is a closed-economy model. See, you just have this economy with labor and capital and two activities. And you get the interesting result that capital tends to bear the full burden, by which I mean it's very hard to twist the parameters so that capital bears only half the burden. And it isn't too hard to have capital bear one and a half times the burden. One times the burden is in the middle there. And that was kind of the message that people drew. And, of course, it is next to being wrong, really wrong in the case of the open economy.

And it was very interesting that around 1970, I had three Chilean students, Miguel Kast, Ernesto Silva, and Juan Carlos Mendez, who were sitting in all of my classes. They took every course I had. And they were just driving. And when I gave this material, they said, "Well, what about the open economy?" We're going to come to that because that was a big story in Chicago in that period of time. But anyway, they asked me, "What about the open economy?" I said, "Well, let's try it out." And so right there on the blackboard we did a quick remodeling of what would this be like if the corporate sector was producing a product whose price was determined in the world market. And what would happen if capital were mobile with its rate of return determined in the world market? How would this change things? And it turned out even in

that first exercise that it had a dramatic effect. And basically, if you have the price of the corporate sector's product determined in the international marketplace and you have the rate of return unchanged and you stick a tax in there, who can bear that tax but labor? The product price doesn't change and rate of return doesn't change. So you get labor bearing the tax. And since labor's wage applies not only in the corporate sector but also in the non-corporate sector labor more than bears the tax. If you have to draw one message about corporate taxation, that's it.

Now, the closed economy remains a relevant model because there was a time when our tax rate was 52 percent and in Europe the tax rates were roughly in that neighborhood, forty, fifty percent and so on. And as time has passed these tax rates have all come down. In Europe they are now around 20 percent, in the United States they're at thirty-five percent. So if you think of the major countries of the world moving their tax rates up and down in some harmony, then the closed economy model comes into play for the world. But if you ask what happens when the United States moves its rate with the rest of the world not moving their rates then you need the open economy model. So for the kind of questions that usually come up about a country's policy, it is the country doing it on its own, so to speak, and there the open economy model is the relevant one.

Well, it turns out that in that little struggle of making the shift from the closed to the open economy in class, it was hard to work with just two sectors. It took me a few years before a light turned on in my head and I got to a model of four sectors, which was a corporate tradable, a corporate non-tradable, a non-corporate tradable, and a non-corporate non-tradable, and that makes all the sense in the world. Corporate tradable is manufacturing. Non-corporate tradable is agriculture. Non-corporate non-tradable is services. And the corporate non-tradable sector is public utilities and internal transport, that kind of thing. That is, I think, the current state of affairs in trying to think about the incidence of the corporation income tax. You had to work the numbers to figure what the result will be. But I think in several papers I have tried to work the numbers to be relevant for the United States and so on. It turns out to be very hard to have labor bearing less than the full burden and easy to have labor bearing somewhat more than the full burden of the corporation income tax.

03-00:22:26

Burnett:

And so is it true that those three students in your class in 1970, is it perhaps because they're coming from the global periphery, as it were?

03-00:22:42

Harberger:

No.

03-00:22:42

Burnett:

No? That had nothing to do with it?

03-00:22:43

Harberger:

What happened there was that they were there at a time when open economy macro was being developed with Harry Johnson and Bob Mundell and later Jacob Frenkel and [Rudiger] Dornbusch, both of whom were students at the very early phases of this and professors at the later phases. But this was one of the great flowerings of Chicago in that late sixties, early seventies time.

03-00:23:22

Burnett:

Well, we'll come back to that in time. But just to cover the kind of response to the literature that was represented by the corporation income tax in 1962. So the conventional wisdom was that consumers or labor or some combination thereof bears the burden of the corporation income tax. That was the essential story?

03-00:23:54

Harberger:

It was just a division of the pie. Economists were saying that some of it had to be pushed forward on consumers and some of it had to be pushed back on labor and some of it was borne by the stockholders. Boy, the stockholders really drove me nuts because how can serious economists think that somehow the rate of return to stockholders would go down but for other investors, who are investing in bonds or in real estate or in other things, that'll stay the same. It's crazy. The capital market, it's a fluid market and whatever happens to the rate of return on stocks has to be happening to the rate of return on other investments in any new equilibrium. So this, I think, was possibly part of the reason why that paper was so widely praised. That it really opened people's eyes to how dumb it was to have the tax falling on stockholders and not other owners of capital. [laughter]

03-00:25:18

Burnett:

It's a bit of a dizzying paper, too, in the sense that you are very careful to specify—you do assume that this is a highly organized capital market?

03-00:25:28

Harberger:

Yes, yes.

03-00:25:29

Burnett:

That you need that for this to work. There are these elasticities of substitution between capital and labor—

03-00:25:39

Harberger:

In the different sectors, yeah.

03-00:25:39

Burnett:

—in the different sectors but using different models. So one is Cobb-Douglas and the other has fixed—

03-00:25:46

Harberger:

Fixed proportions. The general result has this Cobb-Douglas as a special case, fixed proportions as another special case and an infinite elasticity of supply, a

third special case. But the more plausible way to present this thing is in a general model, where those elasticities can take any number that you want.

03-00:26:18

Burnett:

There are several papers about this subject that you write, and one of the key messages that you drive home is how difficult it is to measure burden in a highly fluid, highly dynamic economy with these multiple players. How you make those calls—

03-00:26:42

Harberger:

Exactly.

03-00:26:43

Burnett:

—is an enormous challenge and you end up with a fairly simplified solution that justifies its simplicity, as opposed to the earlier assumption which was simply an assumption that's operating from—I don't want to be uncharitable. I'm not enough of an expert to know. But it seems like there was a—

03-00:27:09

Harberger:

Yeah. This paper, like the work that was done in international trade for some considerable time previously, is an example of what I think is really useful, pertinent, general-equilibrium modeling, where you are placing this corporate tax in an economy and have just a few key relationships that are critical but they do cover the whole economy and you have the parts add up to the whole and so on. Whereas in the earlier literature, people were just scratching their heads and saying, "Well, now we've got this and we've got that and we've got the other thing and we're going to put them all together and here is the result." That kind of thinking is very difficult to imagine in the modern day where people are modeling everything. But at that time my use of it for studying the corporation income tax was an innovation.

03-00:28:49

Burnett:

Right, right. One of the things that you explored in your 1967 paper, "Empirical Evidence on the Incidence of the Corporation Income Tax," and it begins with a kind of an astonishment at some results of a study done by Krzyzaniak—

03-00:29:14

Harberger:

Krzyzaniak and Musgrave.

03-00:29:14

Burnett:

—and Musgrave that showed benefits to corporations from a corporation tax. And that was the paper where you talk about how difficult it is. So there's some sympathy for them. But you and Cragg and Mieszkowski criticized the methods used and one of the big problems was the time series that they chose, right? You've used that kind of critical analysis in other domains, as well. Paying attention to the source data is a part of your Harberger approach to things, I suppose. It's just critical thinking. And so the dependence on the war years would show high taxes and high profits and so it would—

03-00:30:11

Harberger: Exactly. Exactly. Exactly, yeah.

03-00:30:12

Burnett: —make it look that way, so you have to be very careful about not only the criteria that you choose but the time series that you choose. That's very, very crucial. So during these years, late fifties, early sixties, there are new folks coming to Chicago and they begin to change the research landscape at Chicago and elsewhere. There is a story about Ronald Coase, who comes to the University of Chicago and had presented a paper on FCC allocations of radio frequencies and how to optimize that and whether or not a market in that would be a better way of doing things. And there was apparently criticism of this paper and he wanted a chance, I guess, to redeem himself.

03-00:31:17

Harberger: No.

03-00:31:17

Burnett: No?

03-00:31:19

Harberger: There was this famous meeting at Aaron Director's house, I think it was.

03-00:31:27

Burnett: Yes.

03-00:31:27

Harberger: And Milton Friedman was there, George Stigler was there. I don't know about D. Gale. [H.] Gregg Lewis was there, I was there, and Coase was trying to convince us of what later became known as the Coase Theorem. The way it was presented, most of us were skeptical. And by the end of the evening, I think all, or as far as I know, all were convinced of the validity of this. And the Coase Theorem is so straightforward and so simple. That if you have two people and you have some piece of property, and who owns this piece of property should not affect its most economic use. It's most economic use is its most economic use and whether A owns it or B owns it shouldn't make a difference. I think one of the examples was a right of way through somebody's farm. Was that right of way owned by the owner of the farm or by another person? Would it make a difference? It shouldn't make a difference. And if you think of this as any time there is a more efficient way of doing things, there's money to be made, and somehow an arrangement ought to be reachable whereby that money is in fact made and who's the owner will probably get the lion's share of that money.

03-00:33:43

Burnett: But the most economic use is achieved.

03-00:33:44

Harberger: Exactly. If that requires the owner to pay a little side payment to the other person, well, he's dumb if he doesn't do it if it's going to add to his wealth in

the process. So to me, nowadays, the Coase Theorem seems just so obvious. Why did anybody think otherwise at any point in time? Now, of course, the great footnote or more than footnote, qualification that one has to make, is that the Coase Theorem works if there are no transaction costs. If the process of reaching this great solution requires a huge transaction cost, well, they are going to get in the way of that solution. And in the real world we have many, many situations where high transaction costs get in the way. I think the most serious of them is that shareholders in companies don't have any incentive to try to monitor executive pay. So executive pay is determined between the executives and the board of directors, who are appointed by the executives. And there's a lot of evidence to say that the result is that these executives get paid more than they would in an ideal world. And the reason for that is that you and I, when we own a hundred shares of something, have no reason to try to engage in all of that effort to create an organization of shareholders. We're not able to insist on a place on the board of directors and not able to press our views at all of the company's annual meetings and so on. We don't get that result because transaction costs impede that kind of Coaseian solution that would otherwise prevail.

03-00:36:38

Burnett:

So in a sense, democratic governance is a huge transaction cost, in a sense, right? Because if you want to insert that into a corporate environment, this is an extremely costly thing to do. You were thinking about the example that he used, or the FCC. This is a federal agency regulating a marketless domain, right? They're allocating these frequencies to different players based on some criteria other than a price, right? So is the Coase Theorem an effort to then deal with kind of non- or extra-market domains? To problematize them? Or is that too—

03-00:37:36

Harberger:

I am not enough of an expert on the Coase Theorem to try to pronounce on that.

03-00:37:41

Burnett:

Well, just in terms of what you can remember from that encounter. The story goes that it was some comparison between a theorem by Pigou, and the Coase Theorem or what became known as the Coase Theorem. And initially everyone thought that Pigou's pronouncement was more sound and then it ended up being—all the votes going over to Coase in the course of an evening, which was just this electric thing. For someone like Stigler, who remembers it as this electric eureka moment, something that he witnessed that he's never seen before. But the nature of the arguments against the Coase Theorem were just this failure to understand how this would work. If you can remember the nature of the resistance?

03-00:38:42

Harberger:

I can't remember that. My memory is bad to begin with and going back so far to that meeting, all I have is this general summary impression that stuck with me.

03-00:39:02

Burnett:

This is a group of people who are known and become known later as intellectuals who are trying to think differently about the conventional wisdom in whatever domain that is and they're wrestling with this problem and they come to eventually see the wisdom. And this opens up a whole domain of research that has a great impact. So that's Coase's arrival and then he takes over the *Journal of Law and Economics* and that's a whole story there. And also George Stigler comes on faculty in the late fifties.

03-00:39:52

Harberger:

George Stigler came on board at this time. Gary Becker came shortly thereafter. And I think we have to mention [Harry] Johnson and [Robert] Mundell. I believe that in that period of time the most impactful work was done in international trade at Chicago. And this open economy macroeconomics, I can't say it was quite born in Chicago at that time, but it certainly reached its flowering in Chicago at that time and it was a major, major shift in thinking.

03-00:40:44

Burnett:

You talked about the 1970 encounter, figuring how the open economy fits into the burden of [corporate] taxation. Can you talk about your interaction with these thinkers? Harry Johnson is there. You're reading their papers, you're talking to them. How do ideas — I guess that's the question — how do ideas circulate around and through Arnold Harberger in this time? [laughter]

03-00:41:23

Harberger:

[laughter] Well, I certainly don't claim to be in any sense a part of that innovating culture that was happening in the open economy story. Maybe if you want a quick, quick vision of how things got changed, the so-called monetary approach to the balance of payments is a very good starting point. And this monetary approach probably had its seeds in the International Monetary Fund in the early 1950s with Jacques Polak and S.C. Tsiang being key figures. But a very young Bob Mundell was there in some sort of a role. I don't remember if he was an actual employee or he was a kind of a fellow at the IMF. But anyway, he was at the IMF at this very early time. By the time he and Johnson were together in the late sixties and early seventies, they were both very active in promoting this notion of open economy macroeconomics.

So how does the monetary approach work? The idea is that if, with a fixed exchange rate, a central bank prints too much money, what's going to happen is people are going to have more money than they want to keep in their balances. And if you have more money than you want to keep in your balances you have to spend it. And when you spend it it's going to raise

prices, right? Well, that's the closed economy story. The open economy story is it's going to raise prices of non-tradable goods, but the tradable goods have their prices determined in the world market and so you're going to import more and you're going to consume some of your own exportables, so you're going to export less, and therefore you're going to lose reserves under a fixed exchange rate. Your money supply is going to contract automatically. So this whole process of how the economy adjusts, the old story was that when you have too much money, your interest rates are going to go down and your prices are going to go up. And as a consequence of both of these, the interest rates down, it's going to push money abroad on the capital account. And prices going up, that's going to cause you to import more and so on. But what was being discovered in these early days of the monetary approach is that in many small countries, when they're in this situation, this third mechanism of just people spending more out of excess balances, worked so fast that you can hardly detect any interest rate response or any domestic price response. And that was the big insight of the monetary approach.

03-00:45:51

Burnett:

And so with the consequence that it doesn't have a kind of auto-equilibrating effect?

03-00:45:59

Harberger:

No. It reaches an equilibrium faster.

03-00:46:01

Burnett:

Faster, okay. Balance of payments and exchange rates become more and more significant on the world stage for fairly obvious reasons. They weren't necessarily so obvious to everyone but from the late fifties, early sixties, economists were in a growing panic about the position of the United States, and so that's kind of in the background?

03-00:46:38

Harberger:

Yes. This is not an area of Harberger deep study or anything like that, but I had a clear impression that the growing world economy was running ahead of our stock of gold. And the consequence was that at the fixed rates to gold that were established at Bretton Woods, the economy was growing much faster than the gold reserves and something had to give sometime. And, of course, in the early Nixon Administration we actually went basically into a freely floating exchange rate system.

03-00:47:39

Burnett:

And so there's a lot of questions about the nature of the global economy at that time, sort of feeding into some of the Chicago research that was taking place. And George Stigler arrives I think in '58.

03-00:48:02

Harberger:

Fifty-eight or thereabouts, yeah.

03-00:48:03

Burnett:

And '61 is some of his early research on the importance of information and the nature of the firm and all of that. Was that research stimulating to you at all or were you more fully captivated by development economics at that time?

03-00:48:28

Harberger:

Well, I would say industrial organization was distinctly peripheral in my whole story. I get linked to that field because of my monopoly paper from 1954, but that was a paper that I had promised to present at the American Economic Association meeting and here I was, this young guy, kind of in a panic, what am I going to say, and then I latched onto this National Bureau book by Epstein, I think his name was, which had his data on corporate profits and bang, I jumped onto that and received a lot of acclaim in the end. But it was something that took maybe a month of my time and not part of my continuing—

03-00:49:42

Burnett:

Right, interest or—

03-00:49:43

Harberger:

—ongoing research and study.

03-00:49:44

Burnett:

Right, right. It becomes so important for other Chicago researchers later. Well, I guess even at the time Milton Friedman was interested in the problem of monopoly. But then later Stigler becomes very interested and then Robert Bork and Richard Posner. From a distance you are one of the early Chicago thinkers. Well, post-World War II, you're one of the early Chicago thinkers in terms of rethinking the impact of monopoly on markets. It sounds to me as if you didn't continue to have direct conversations with Stigler, let's say, or some of his students about that.

03-00:50:44

Harberger:

No, I was not involved. Surely on some doctoral committees of which Stigler was chair. But I can't remember myself pushing any monopoly-type study with my own graduate students.

03-00:51:14

Burnett:

Yeah, yeah. You talked about that first cohort of people in your first Chicago workshop and how productive they were. This is Zvi Griliches. And who else? Marc Nerlove was writing his dissertation.

03-00:51:32

Harberger:

[Mark] Nerlove, [Gregory] Chow, Dick Muth? Yeah.

03-00:51:36

Burnett:

And Zvi Griliches stays, comes on faculty, is that right? Is he initially a lecturer and then becomes—

03-00:51:47

Harberger:

As I remember, he was an instructor first and then he became a line faculty member and when he went off to Harvard. We tried to keep him but we did not succeed. [laughter]

03-00:52:10

Burnett:

But during the time he was there did you continue a relationship with him intellectually and—

03-00:52:15

Harberger:

Of course. Of course. Yeah.

03-00:52:17

Burnett:

Yeah. And his work continued to help you think through your problems, as well, a little bit?

03-00:52:25

Harberger:

We were on different tracks, so to speak.

03-00:52:36

Burnett:

What about Carl Christ?

03-00:52:41

Harberger:

Carl worked on the Manhattan Project during the second World War. As a young undergraduate BS in physics he somehow got involved there. And I was in the Army and I got out of the Army in March of '46 and went to Chicago and took an economics course with Bert Hoselitz, and who was in this course but Carl. So we were the two best students of Hoselitz in that course, okay. Come the end of our career and we were both research assistants at the Cowles Commission, writing our theses financed by the Cowles Commission. Then I go to Hopkins in '49 and in '50 or '51 Carl comes to Hopkins. And we were assistant professors together at Hopkins. And then I go to Chicago in '53 and he comes a year or two later to Chicago as an associate professor. We were both associate professors together at Chicago. So our careers just paralleled each other in a crazy way, as if we were Siamese twins almost. And then we both got offers. Carl, Telser, and I got offers from Hopkins, for the two of us, Carl and me, to go back, and Telser being thrown in to the package. And when the dust settled I stayed at Chicago, Telser stayed at Chicago, and Carl went to Hopkins where he stayed for the rest of his career.

03-00:54:46

Burnett:

So you had these parallel careers but not much intellectual interaction in terms of your—

03-00:54:54

Harberger:

Not really. One interesting little thing was that when we were assistant professors at Hopkins, we took a math course together at Johns Hopkins to build up our mathematical skills. And I remember I used to go over to Carl's apartment and we would sit doing the homework problems of this math course

as full PhDs, assistant professors, and still learning together. And it was quite a lot of fun.

03-00:55:36

Burnett: Wow. What kind of mathematics were you working on?

03-00:55:40

Harberger: This was advanced algebra.

03-00:55:41

Burnett: Okay, okay. That seemed to serve you well. So one of the things, you did a workshop in public finance that was so generative of new ideas and you mentioned the way that you ran it. You gave them the freedom they may have lacked had they worked with some—

03-00:56:07

Harberger: Elsewhere.

03-00:56:09

Burnett: —perhaps more doctrinaire folk. Jumping a little bit ahead here. In '65 there was a workshop in international economics. Were you running that? Were you participating?

03-00:56:26

Harberger: No. The trade workshop was Mundell and Harry Johnson.

03-00:56:32

Burnett: That was the workshop. Okay. That makes sense then. So there are new faculty. There's Stigler and Gary Becker is not yet back. But you become the department chair. It's time for your turn, I suppose, as Al Rees departs. It's 1964 and you mentioned preservation was more the goal rather than the building entrepreneurship of, say, a Ted Schultz. Can you talk about what your understanding or your vision for the department was? What were some of the challenges when you took over in '64 that you felt needed to be looked at?

03-00:57:31

Harberger: Not too far down the hierarchy of economics departments, the chairman sits around and every now and then somebody will get an outside offer and they'll have to deal with that and so on. Well, at Chicago virtually everybody in the faculty, anybody in the faculty who wanted to cultivate an outside offer could do so. And so the task of the chairman was to fight back against these things and when somebody left that would leave an opening, so to speak, and the issue was to fill the opening. Well, one of the characteristics of Chicago all the time was hardly ever did we search for people by field. There were fields that we just had to deal with. So that when the Cowles Commission left, for example, that was when Carl Christ came. But we had other people, Bob Bassman came, and so on. And we only really restored ourselves to leadership in econometrics when we had Henri Theil joint with the business school and then Arnold Zellner came also the business school. But our relationships were

such that our students took courses with both of them. I don't think we need list the feud that ended up developing between those two. It's peripheral to our purpose here. But certainly our students were exposed to top class econometrics, and this was a big challenge and stimulus at that time.

03-01:00:17

Burnett:

Do you mind my asking about the nature of that feud that developed?

03-01:00:24

Harberger:

Well, what happened was that Henri Theil had been director in Rotterdam of an institute and in Europe the director of an institute is the emperor of that institute. It seemed to be true, and I believe it was true, that Henri Theil was a co-author of every paper that came out of that institute, just to give you a notion of his power. So he comes to this joint appointment with the department of economics and Graduate School of Business and he wants to bring somewhat younger people. So he invites Zellner to come, I believe from Wisconsin, join him. And he comes to visit and they have a wonderful time together and Henri Theil becomes the most ardent advocate of making an offer to Zellner. And Zellner accepts the offer and comes. And then, by God, he behaves like an equal. How can that happen?

03-01:01:43

Burnett:

So there's a bit of a culture clash.

03-01:01:47

Harberger:

That was a problem. My friendship with George Shultz began with that feud. We had to deal with this. And what happened in the case of economics, when I named committees for the econometrics prelim, which was given twice a year, one of those times Henri Theil would be chairman and Zellner wouldn't be on it, and the other time Zellner would be chairman and Henri Theil wouldn't be on it. And it was that serious. But somehow it was a quite livable situation for quite a substantial period of time. And interestingly, when Henri Theil left he went to, I think, Florida State University which is a much smaller pond in economics but undoubtedly he was emperor there. [laughter]

03-01:02:52

Burnett:

Well, you saved my having to ask the question because of course George P. Shultz becomes dean of the Graduate School of Business right around the time that you become chair of the department—

03-01:03:07

Harberger:

Correct, correct.

03-01:03:08

Burnett:

—at Chicago. And so there's two questions. One is about that relationship. And also about the relationship between the Graduate School of Business, the economics department, and perhaps the Law School, as well. I understand that the law school changes some real estate. They move across the way.

03-01:03:30

Harberger:

Yes. They moved across the way and they were across the way, as I remember, all of this time we're talking about. And we saw very little of Coase. I'd say almost nothing. But with the Graduate School of Business we had a lunch table in the faculty club. It was an economists table and it was open to people from the business school as well as from the economics department. Sometimes it spilled over to two tables but it was a very interesting interactive lively place. And you can say one could not tell the difference between—we had Merton Miller, we had Arnold Zellner, who were pure business school. Henri Theil and Stigler were joint with the business school. And we just had a wonderful time.

03-01:04:47

Burnett:

And were there ever decisions made about, not necessarily hiring, but complementarity? You mentioned that you could get econometrics from the business school and you'd send your students over there. So was there a symbiotic relationship that was cultivated and deliberate or was it more like it was just a meeting of the minds from the get-go?

03-01:05:12

Harberger:

I don't know quite how to put it. The business school was a lot bigger. I wouldn't be surprised if the business school didn't have nearly as many economists and closely related people as we had in the economics department. We never had more than twenty-five in the department. Many workshops, at least, had faculty members from both places. Not all workshops. Public finance was by itself. But certainly IO [Industrial Organization] was very mixed. Peltzman was in on that, as well as others. So I don't know. As I remember, certainly the Henri Theil/Zellner thing was the apex of my relationship with George. But we had a social life together and so on. He came to our New Year's parties and we went to his house. His sons came over. We had a big house with a basement with a pool table and he had three or four sons, I remember, and they would come over. I never saw them but Anita would tell me that they came to play pool. [laughter]

03-01:07:02

Burnett:

That's phenomenal. So there's these layers of social interaction. There's obviously the formal things and then there's the Quadrangle Club. There's a table there for Chicago folks and Graduate School of Business folks. And then there's the city itself. Hyde Park, I mean the neighborhood in Chicago. Can you talk a little bit about that? Is that something that others have mentioned being significant, that your Chicago colleagues were often your neighbors. Was that true in your case?

03-01:07:46

Harberger:

Well, certainly the university community was bounded by Forty-Seventh Street, Sixty-First Street, Cottage Grove, and Stony Island, pretty much, and maybe two square miles there where people lived. And very interestingly, I'd say the neighborhood there has improved a lot since certainly the worst

periods in the fifties, sixties, seventies, and so on. But there seems to be more of a tendency for people to live other places in Chicago. Bob Topel lives downtown. Bob Lucas lives downtown. And there seems to be less of a neighborhood connection. But at that time Stigler always lived in Flossmoor. Lloyd Metzler lived in Flossmoor, which is a southern suburb of Chicago. So we weren't all in the neighborhood but certainly most colleagues, Friedman and Schultz and Telser and Griliches and Becker, Tolley, Sjaastad, me, Heckman, all in the neighborhood.

03-01:09:39

Burnett:

Yeah, yeah. You mentioned there was a New Year's party. Were there social events that were not just the scholars but the families, as well? Was that part of it or not so much?

03-01:09:55

Harberger:

Well, how can I say? The party crowd, meaning Mundell, Johnson, me, Sjaastad, to a degree Bob Fogel, we were always at each other's parties. And I would have a whiskey sour breakfast on New Year's Day. I made the whiskey sours to be about like white wine, not too intoxicating, and these were supposed to help people recover from the night before.

03-01:10:52

Burnett:

The good old days.

03-01:10:53

Harberger:

We used to have maybe sixty, eighty people for these breakfasts—people both from the business school and from the economics department. A couple of interlopers from physics, something like that. But it became an institution, so to speak, and everybody liked it.

03-01:11:20

Burnett:

Yeah. And you had also mentioned that the Chilean students had their own kind of party circuit or they had their own building where people would come.

03-01:11:32

Harberger:

This was earlier, see. This was at the time when I met Anita.

03-01:11:39

Burnett:

Yeah, in the late fifties.

03-01:11:40

Harberger:

I was a bachelor and was living in a coach house instead of this big one that we bought later. So they had these parties on Saturday night. That, I think, was a creature of this particular group of De Castro, Fontaine, Jeftanovich, Fuenzalida, and Miranda that lived in that particular place in that particular time. It wasn't something that went on and on and on.

03-01:12:16

Burnett:

Yeah. You talked, and many others have talked about the culture in Chicago as being driven by the arguments. That ego had no place. You had to check

your ego at the door lest it be wounded and your reaction to Henri Theil coming and assuming this kind of—I don't know how to call this—

03-01:12:45

Harberger:

Hierarchical.

03-01:12:46

Burnett:

Hierarchical order which many other scholars I've talked to have talked about: the difference between European social hierarchies in academia and the American style. And Chicago sounds like a particular instance of a kind of collegiality that really supported the advancement of research. Now, there are probably some qualifications to that.

03-01:13:15

Harberger:

Well, that is a very interesting thing. I have mentioned many times in speaking about Friedman's influence on me that he never wanted you to support an argument with a name, that the fact that Hayek was for or against something added zero to anything. You had to deal with the issue and only the issue, not other things. Friedman in particular never asked who said what on any exam. I never asked who said what on any exam. And this was pretty broadly felt through Chicago. I have had recent experiences with a British trained colleague that were kind of interesting because I said some remark in a meeting, that, "I couldn't care less about what somebody said to somebody," or who developed what idea in the fifth century or the seventh century or the twelfth century. What was the idea and was it right or wrong? And I remember this guy and his wife got scandalized by me saying that. No interest in the *dogmengeschichte*. [laughter]

03-01:15:30

Burnett:

Well, this culture seems to be at its high point in the fifties and into the sixties at Chicago. One other piece of it, and I don't know how much you would have known about that in your position as chair, but at the Graduate School of Business, because of his appointment, George Stigler had—I think we talked a little bit about this before, but he became a kind of real builder, trying to bring scholars in. Do you know much about that? He had the Walgreen Fund and he was able with that to do some—

03-01:16:27

Harberger:

Well, the way I viewed it, at least, was this was money that he had which was financing the IO workshop. And the IO workshop was joint between Business and Economics. And he used that fund to give fellowships to graduate students in Economics. I don't remember that he ever funded any appointments. But my memory is not that great that I could be sure of that. But on the other hand, we got later on a lot of money from the Ford Foundation to support the workshop system and we had Ford money supporting a lot of workshops and probably wasn't supporting the IO workshop because it had its separate funding from Walgreen.

- 03-01:17:31
Burnett: Right, right. And you also mentioned earlier that in '65 you have the Latin American workshop or not—
- 03-01:17:40
Harberger: We had the Latin American workshop with a separate Ford financing, yeah.
- 03-01:17:45
Burnett: Right. And that, you mentioned earlier, was this—
- 03-01:17:49
Harberger: The Center for Latin American Economic Studies was financed by Ford. Yeah.
- 03-01:17:53
Burnett: Right. And that you were able to bring in students on a regular basis. You had initially gone with the Chile Project. And Argentina, too. That that's '62 to '67, I think, that there's—
- 03-01:18:10
Harberger: Sixty-two to sixty-seven is our Argentine project, correct. Larry Sjaastad. Larry was a fellow student of Fontaine, De Castro, et cetera, et cetera. And he was made an honorary Latino by them. So he was always at those Saturday night parties and so on. And then he got his PhD with me on migration, it was a very great paper, and went to Minnesota. And when we got this money for the Argentine Project we attracted him back to Chicago to be our man on the scene in Mendoza. So he went there for the first couple of years, maybe a little more than two years, after which part of the deal was he would come back as an assistant professor in Chicago. And then he evolved into being my right-hand person in Latin American matters and ultimately got tenure and so on and so on.
- 03-01:19:28
Burnett: At Chicago?
- 03-01:19:30
Harberger: At Chicago, yeah.
- 03-01:19:32
Burnett: And so does that figure into some of the project evaluations that you were doing in different countries there or when you say a right-hand man—
- 03-01:19:44
Harberger: We were both very active in Latin America and there were a number of times—we worked in Uruguay, in the period of liberalization in Uruguay. We were there pretty much with AID from '74 to '80 or '81 and we were going every year to Uruguay, but we were each working on different things when we were there and we certainly interacted. I remember on different occasions, in Rio and Sao Paolo, we were simultaneously there. In Chile, different occasions when we were simultaneously there. But it wasn't that we were

particularly working on the same thing in these times when we overlapped. In the projects course we had a really interesting thing. I don't remember if we were teaching the project course jointly or if I was teaching it and I was going away on one thing and another. But in any case we had this course in our heads to the point where if I was going away I'd say, "Larry, I just got to this point in the course. Now, you just pick up from there." And he would pick up from there and then I would come back and he'd say, "I got to this point in the course," I would pick up from there and the students didn't know the difference.

03-01:21:42

Burnett:

Wow, that sounds like a pretty integrated system. Because the volume *Project Evaluation*, which becomes the kind of text, right, because it's an assembly—

03-01:21:54

Harberger:

The project evaluation book was published in 1972 and I have to say that—you have to see the whole Harberger, so to speak, not just the bright side. If left to my own devices, probably neither *Project Evaluation* nor *Taxation and Welfare* would ever have been published. Just too much drudgery to put such a thing together. There was a graduate student named Dan Wisecarver who was a prince in my life really in so many ways. He pushed and pushed and pushed and offered his services to help put these things together. And these two volumes really owe their existence to Wisecarver. And, in some sense, so does any benefit that my career may have received as a consequence of these publications of books, they were all collections of papers.

03-01:23:15

Burnett:

That's right. Yeah.

03-01:23:18

Harberger:

Any benefit my career might have got, part of that goes to Dan Wisecarver.

03-01:23:26

Burnett:

Sure, sure. *Project Evaluation*, these are papers that have been written over the course of about ten years prior?

03-01:23:36

Harberger:

Correct.

03-01:23:38

Burnett:

And they were the raw material of your course, is that right?

03-01:23:44

Harberger:

Correct, yeah.

03-01:23:44

Burnett:

I hadn't thought of getting into this right now, but this course, how was it structured? You had your readings of things. Did you include readings from others that you disagreed with and you'd sort of walk them through different kinds of arguments? How did it work?

03-01:24:19

Harberger:

Not particularly. We had alien material on the reading list and we brought up these issues in the course of the class. But the function of the course was to capacitate the students with what we thought was state-of-the-art stuff. So when we disagreed with something we thought it was wrong. [laughter] You understand what I mean?

03-01:25:02

Burnett:

Right.

03-01:25:03

Harberger:

It's not, "Oh, well, there's this way and then that way and then the other way," which you find a lot in academic work. But this was never a part of any of my courses. I don't think that we were in any sense rigidly dogmatic in the bill of goods that we were selling. I think we were down the line, solid, tradition-based but evolving economics. And I think that there is an interesting story there. In project evaluation, our way of thinking was one and then there was Little and Mirrlees and then there was Squire and van der Tak and then there was the UNIDO guidelines. And why is it that three decades later none of those others are around and our so-called scheme is there as the fundamental basis of what's going on? Well, what is the difference? It's that we were more modest. We didn't try to have a great innovating thing. Little and Mirrlees talked about the wage of labor as a macroeconomic phenomenon and we said, "Come on. 'W' is the wage. I'm hiring rocket scientists over here and sweepers for the hospital over there, and what the hell does a macroeconomic 'w' mean to me? I have to talk about the market wage of rocket scientists in Alamogordo, New Mexico. That's what I want to talk about. And I want to talk about the sweepers in Billings Hospital in Chicago." Wages vary by place, by experience, by time, by everything else. What's the market wage for this kind of labor in the place that you're talking about at the time you're talking about. This is not smart economics. It's common sense. But our line was always in that vein, that we wanted to think about actually doing real evaluations in real-world context, building on the long evolution of applied welfare economics, and not overburdened with idiosyncratic nuances and niceties.

Distributional weights is another crazy thing. Several of these competing systems bought into distributional weights like nobody's business. And it sounds so great, that obviously an extra dollar in the hands of a millionaire can't be worth as much as an extra dollar in the hands of a pauper. So now if you start building a curve where that extra dollar's value declines as a person's or family's income rises and you get to a point where it's worth two at certain low income and it's worth only 50 cents at a certain higher income, well, that means if I take one dollar away from somebody where it's worth a 50 cents, that costs society a half dollar and if a lot of that dollar leaks away in the process of my giving it to this pauper, suppose three-quarters of it leaks away in inefficiency, he only gets twenty-five cents. But that's worth twice as much to society. So we can accept this project even while losing three-

quarters of this thing in the process. And if you apply distributional weights you're going to apply them to the point where at the margin you're actually just barely equal. It has such profound implications about taking away from these and giving to those that I don't know anybody who really believes that such a system should be guiding our economic policy. And yet it had such plausibility at the beginning. You have to go through the exercise in order to see how drastic the implications of it are and how unwilling societies are to accept those implications, that you have to look for other things.

Evolving from that, I wrote a paper on this in the late seventies and ended up kind of groping for some alternative way of dealing with issues of distribution in project evaluation. And we ultimately came up with the idea of basic needs as being interesting—we call them basic needs externalities. That adding to the bad housing, improving the bad housing of a poor family gets extra weight, and improving the nutrition of a poorly fed family gets extra weight and so on. And this approach of thinking of distributional considerations in terms of basic needs has more legs than the distributional weights idea.

03-01:32:20

Burnett:

Did that idea of distributional weights have its origins in some of the early enthusiasm about development, this notion that capital moved into a poor area is going to be worth so much more? That's almost the refrain, no?

03-01:32:40

Harberger:

No, I don't think that it came in in that way. It's something that has its origin with the utilitarians back in the early nineteenth century, Jeremy Bentham and so on. Where they thought of marginal utility as a function which was transplantable across people. So interpersonal comparison as well as inside of one person's utility. The use of indifference curves in economics represented a further step where you didn't have to have a declining marginal utility of money curve in order to have indifference curves give you all the results we had before, so to speak. Demand curves sloped downwards. Income expansion curves sloped upward and so on. These results can happen with indifference curves just as well as with an underlying downward-sloping marginal utility function.

03-01:34:03

Burnett:

Well, the basic approach to your course and your research was that this was project evaluation. So using a global wage variable—

03-01:34:25

Harberger:

Oh, they were talking about projects.

03-01:34:27

Burnett:

Yeah? That's the weird—okay.

03-01:34:28

Harberger:

That was the problem, that these alternative schemes, each one had its own idiosyncratic thing which the authors felt was theirs, so to speak. And we

thought of our scheme as something which took a long history of applied welfare economics in the past and built on it incrementally in various different ways. I wrote this paper in '71 on three basic postulates which says what's a unit worth to you? It's what you're willing to pay for it. And what's an hour of your labor worth to you? It's what you're willing to sell it for. And when we try to compare across people we just add up these things: demand price, supply price, adding up. These are the three postulates. And, by God, you put these things on a three-by-five card and you put that card in your back pocket and you go around the world and view it with problems—all of applied welfare economics as we have inherited it comes from that. [laughter]

03-01:36:02

Burnett:

Wow. Well, three cheers for the three-by-five card.

03-01:36:09

Harberger:

Yeah.

03-01:36:14

Burnett:

Just to get a sense of your workday in the 1960s as much as we can pin it down. Did you get a course release for being chair?

03-01:36:33

Harberger:

No.

03-01:36:34

Burnett:

No. It was just an added responsibility.

03-01:36:37

Harberger:

That's right. But we only taught one course per quarter anyway. So it was no big deal. Also the chairmanship was not that onerous. And the reason was that even though, as I said before, anybody could generate an outside offer at any time, there were a limited number of serious challenges per year that you had to deal with. When you aren't losing people you don't have to worry that much about recruitment. We had to recruit assistant professors because there was turnover at that level. And we would go to the meetings each year with usually one or two slots, rarely more, that we wanted to fill. Rarely did we look for a field. We just looked for the smartest people we could find at the senior and at the junior level. And that creates a certain evolution in the department over time. Just that simple act of always trying to find the smartest people has a tendency to pull the department in the way economics is trending. So when I bemoan the super-tech wave that has taken over economics and how did it get to Chicago, well, going for the smartest people. And each time, since those smartest people are probably gravitating toward this ongoing current trend, your evolution is going to be in that direction.

03-01:39:10

Burnett:

Right, right, more emphasis on the formalist computerized modeling and that kind of thing. Was there a phenomenon of people turning down offers that

were financially more lucrative than Chicago? Were there costs to staying at Chicago?

03-01:39:35

Harberger:

Well, it's hard to say. I can't remember precisely. I remember matching offers from outside, even when the offer was from a place that we didn't think was quite as good as Chicago. But I don't remember specifically overmatching. But certainly when we were trying to hire people, somebody from outside, we would typically offer them a significant upward bounce in salary. No doubt about that.

03-01:40:30

Burnett:

Yeah, yeah. I was just thinking of what Gary Becker wrote when he described coming back to Chicago. They said, "Harvard is Harvard. Why didn't you stay there?" And he said—

03-01:40:45

Harberger:

Gary was at Columbia.

03-01:40:48

Burnett:

Sorry, Columbia, excuse me. I don't want to misquote. *Someone* important who returned to Chicago said about the university that he was leaving, that that economics department was not a department. And I took that to mean—

03-01:41:12

Harberger:

Sounds like Columbia.

03-01:41:13

Burnett:

Yeah. I took that to mean that it didn't have the social cohesion or the intellectual cohesion.

03-01:41:20

Harberger:

Oh, that's absolutely true of Columbia, more so than MIT or Harvard or Stanford, for example. Being in New York and having so many outside possibilities and the neighborhood not being the greatest asset and so on, I believe there was a tendency at Columbia for people to appear for their office hours, to appear for their classes, to appear for their workshop, whereas at Chicago they were there all day. D. Gale was there at 8:00 in the morning almost every morning. I and a few others were there into the late hours at night many times a week and on weekends, you could sometimes find half the department there on a Saturday afternoon. And that's a difference.

03-01:42:27

Burnett:

Absolutely. I think Deidre McCloskey said—it was humorous. Said that people worked so hard at Chicago because there was nothing else to do. [laughter] Hyde Park was a sleepy place?

03-01:42:45

Harberger:

Well, that fits with what I said about Columbia. [laughter]

03-01:42:50

Burnett:

The bright lights of the Big Apple were too much of a distraction. Yeah. And there were at least three, right? There's Becker, Stigler, and Friedman, for a while. He was at Columbia for a while and then he came back.

03-01:43:12

Harberger:

Well, he wasn't at Columbia. He was not at Columbia before he came.

[Ed. clarification: Stigler graduated from the University of Chicago in 1938, and was at Columbia from 1947 until 1958, when he returned to Chicago. Both Friedman and Stigler worked at Columbia during World War II doing statistical research for the war effort. Friedman graduated from Columbia and was later there for a year, 1964-65. Becker graduated from Chicago in 1955 and was at Columbia from 1957 to 1968, before returning to Chicago for the rest of his career.]

03-01:43:17

Burnett:

I was wondering if there was some kind of special attraction to Columbia for these folks. Maybe it was Arthur Burns or something.

03-01:43:30

Harberger:

Well, the National Bureau was located at Columbia at that time.

03-01:43:32

Burnett:

Okay, okay. So that was the big draw.

03-01:43:34

Harberger:

I imagine.

03-01:43:35

Burnett:

Right, right. There was a cohesive intellectual community and a cohesive social community that made Chicago special and didn't make your job too onerous when you were chair of the department.

03-01:43:50

Harberger:

Exactly, exactly, exactly.

03-01:43:51

Burnett:

So Gary Becker arrives in '68. That's right. He arrives in '68 and his big book *Human Capital* comes out in '64. Can you talk about his arrival to the department, what you remember of it, and the hiring process and all of that? Do you recall any details about his arrival, how he was received?

03-01:44:33

Harberger:

He was eagerly sought after and I think it was not a hard sell. He could have been the person that you were referring to. [laughter]

03-01:44:51

Burnett:

Yes, I think so. Yeah.

03-01:44:53

Harberger:

It was not at all hard. He was happy to come and we were happy to get him and what more can be said? And he immediately moved into a key role in the department, say almost any new full professor might be expected to do but let's say—even though each may have made a contribution to the department's life, there are some whose contribution was bigger than others and Gary was certainly one of them. Harry Johnson was another one. [Robert] Mundell was another. They were all really catalytic people in the department when they came.

03-01:46:03

Burnett:

And for sort of continuity of narratives here, T.W. retires in '67 officially. My understanding from—

03-01:46:16

Harberger:

It doesn't make a bit of difference.

03-01:46:17

Burnett:

It doesn't seem to. I see all of these photographs from into the seventies and the eighties and his publication record. So that was kind of “on paper” he retired.

03-01:46:26

Harberger:

Yeah. Did you ever see this picture of tall Schultz marching in the snow in the winter and he has on the bottom of it written, “A bear thinking of hibernating”?

03-01:46:39

Burnett:

[laughter] I have not seen those.

03-01:46:43

Harberger:

He gave one of these to Anita. He was very fond of Anita. And she had it built up into a poster that hangs in our dining room in Brentwood right now. A full-length poster of T.W. marching in the snow, age eighty or something like that. Eighty-something.

03-01:47:04

Burnett:

Right. Wow. So he continues to be this figure. He's going to workshops. He's continuing to come to his office. He retains an office and continues to write and is productive, and I'm assuming is keeping abreast of the trends. I'm sure he understands how Gary Becker takes off with human capital and he becomes interested in that.

03-01:47:45

Harberger:

Yeah. I don't want to push too far. Ted was writing pretty much to the very end. I remember he would give me things that he had written and I would edit them to include some nuances that were maybe more recent than he had in his head at the time when he was writing and sort of bring them more up to date, to have them not look old-fashioned. Let's put it that way. And D. Gale did the same thing with helping Ted.

03-01:48:50

Burnett: Keep up to date with the changes in language and concepts.

03-01:48:56

Harberger: But he was just amazing.

03-01:48:58

Burnett: Yeah. So there is some turnover at Chicago but just making room for explosive new talent, like Gary Becker. I'm thinking about this tension between new scholars who are clearly part of a tradition. Gary Becker's from Chicago. He was clearly part of a tradition. But in terms of the formation and the nature of the core price theory, for example, was that core changing during that period, from the time that people were teaching earlier into the 1970s? What was changing in price theory?

03-01:49:54

Harberger: Well, I don't see it. I taught price theory I think almost from the first, 1953, until 1984, maybe. What happened was that when I became a full professor at UCLA—there were those seven years where I was both at Chicago and at UCLA—and in those periods I taught the tax course and the projects course. Yes, that is correct. The tax course and the projects course in both places. And that meant in Chicago I gave up price theory. So it would be from '53 to '83 that I was teaching price theory every year.

03-01:51:16

Burnett: Thirty years.

03-01:51:18

Harberger: There was some modest evolution of the material and the way it was presented but Chicago price theory was Chicago price theory at the beginning and recognizably so at the end.

03-01:51:41

Burnett: I think some scholars have talked about the extent to which Gary Becker's price theory was different, I suppose in terms of his research. But I don't know if that had any impact on the core curriculum at all.

03-01:00:23

Harberger: I was on the core committee most of the time over all that period and I certainly didn't have an impression that there was any drastic difference between Gary's and other people's questions. Thinking out loud, almost, I can easily see how Gary could be asking a question that had to do with the economics of crime, or more the economics of education than maybe others would have asked. But it's still basic price theory. And it's still Chicago price theory.

03-01:53:23

Burnett: Right, right, right. Great. Why don't we take a break?

03-01:53:29

Harberger: Okay.

Session 3B, Afternoon

03-01:53:33

Burnett:

This is Paul Burnett interviewing Dr. Arnold Harberger. We're still in our third session. It's now the afternoon of November 30, 2015, and this is part of the Economist Life Stories Project with UC Berkeley Oral History Center and the Becker Friedman Institute in the University of Chicago. We were just talking about your time as chair of the department at University of Chicago and we were talking off-camera about some of the important figures who moved through the department. You were talking about faculty but also there are tremendous students during that period. Can you talk about some of those figures?

03-01:54:20

Harberger:

Oh, my goodness. Well, I was at that moment thinking about the really flourishing of international economics at Chicago in the sixties and into the early seventies. Harry Johnson had come over from England somewhere around 1959 and his was an interesting case. He came with a bit of a chip on his shoulder vis-à-vis Milton Friedman, which showed in a number of different ways, some of them very productive and others maybe not so productive. I think he gave an important lecture sponsored by the American Economic Association in which he talked about monetary economics and so on. And he showed himself in that to be, let's say, considerably more Keynesian than Milton Friedman, which doesn't take a lot of work. But the idea of there being a significant chasm between them was pretty evident there. But as his time at Chicago evolved, osmosis seemed to take place. And by the end he was not in any sense a clone of Milton but he was definitely on the side of most of us in terms of the respect that we paid to monetary processes in economics. The issue of Keynesian versus non-Keynesian annoys the hell out of me, but it's there.

The problem is that when the war ended and the predictions of continued stagnation of the economy, where would the demand come from in the post-war period, da-da-da. As those things faded into distant memory, so to speak, never really happened, and we were living in a world of full employment and lack of effective demand was the last of our problems, when prices were doubling, Lord Keynes at that time, while he was still alive, said, "My economics, the general theory, is not applicable in these times. These are the times when Marshallian economics and standard neoclassical economics is what should be applied." So Keynes knew it but others didn't. His followers didn't. So there were people who labeled themselves as Keynesian and

pronounced themselves as practicing Keynesian economics when they were doing things that Keynes was disavowing. So that's sort of a mess. But post-Keynesian economists say that there are times when effective demand is indeed a problem and times when it is not. And when it is a problem the mechanisms of Keynesian economics have some meaning. They have been rehoned and rehoned and refined in many ways. But I'd say modern economics, of which Bernanke would be a wonderful example, is not Keynesian in the old-fashioned sense. But God only knows they worked very hard on effective demand and yet at the same time they are fully recognizing the relevance and continued relevance of good old-fashioned neo-classical full-employment economics. When? When your labor market is pretty substantially in equilibrium. And that's the end of that story. But in any case, the Keynesian-monetarist controversy has been exaggerated on both sides of the story, monetarists not ready to find useful the techniques of stimulating effective demand when indeed they're called for, and we have many examples of this in the recent Great Recession. And so you get that, and you get the Keynesians who are wanting to have spending sprees and deficits in all times, good and bad. So there you go.

03-02:00:30

Burnett:

So Harry Johnson, his Keynesianism became attenuated.

03-02:00:35

Harberger:

His Keynesianism became attenuated and I would say he became a member of the, not neo-Keynesian, but post-Keynesian clan, where we understand the usefulness of Keynesian economics in its place and we understand the usefulness of standard economics in its place and we try to know the difference. [laughter]

03-02:01:03

Burnett:

Right. And you mentioned in the first session this morning, talking about the research on the open economy.

03-02:01:12

Harberger:

Yeah. So I wanted to emphasize that in this period of Mundell and Johnson being simultaneously at Chicago, they really attracted the best at that time, of which Rudi Dornbusch, Jacob Frenkel, Michael Mussa, Richard Blackhurst, all these were very key people. Frenkel and Mussa both became chief economists of the International Monetary Fund, one after the other, and after his service in the Fund, Frenkel became head of the Central Bank of Israel for two terms and did a very distinguished job there. And they just had an important impact on the international economic scene in this period. Dornbusch became co-author of Dornbusch and Fischer, which is a very famous macroeconomic text. Dornbusch became a virtual apostle of modern open-economy macroeconomics in that period. The people who think that Chicago economics was Milton-Friedman-type, Stigler-type economics, or the Schultz/Johnson type economics, the D.-Gale-Johnson type economics, should not forget that there was this other center there of, in some periods, at least,

greater impact than the others, certainly of roughly equivalent importance to the others that made its mark on the history of the world economics profession.

03-02:03:33

Burnett: In that larger context you were thinking about the incidence of corporation tax in an international context. So that model is somewhat influenced—

03-02:03:53

Harberger: The three students who were in that class asked me that question because they had fallen under the influence of Harry and Bob in the open economy revolution. Yes.

03-02:04:13

Burnett: So there's a circulation of influence.

03-02:104216

Harberger: Very much.

03-02:04:16

Burnett: So even though you may not have been speaking directly with Harry Johnson the students were kind of—

03-02:04:26

Harberger: Well, I was speaking directly to Harry Johnson [laughter].

03-02:04:32

Burnett: It's additional.

03-02:04:33

Harberger: The thing is that that piece of that story had not inserted itself into the incidence of the corporation income tax until those kids asked that question.

03-02:04:45

Burnett: Right. I suppose that's what makes the academy in many ways, right? So there are students coming from all over the world to study at University of Chicago. Is it partly that they're coming from different university traditions in economics? Does that have an influence or shape them?

03-02:05:10

Harberger: No. I think students come with a sort of blank slate aspect to them and they get exposed and then they get involved and in a particular environment, which certainly was true of Chicago for almost all the time, there's always something on the frontier, in one sense or another, of economic science going on. The best students usually get attracted in that direction and often evolve and become leaders in the next generation. And that certainly was happening in this period of time, especially in this field of international trade. I think it's fair to say that in terms of impact on the developing world, these students went through and through the international phase. Had more impact than those

going through other phases of economics at Chicago at the time. And then later on the agriculture and development side had its own day, so to speak.

03-02:07:08

Burnett:

Well, let's save that for later. I want to talk about the sixties and just a couple of more pieces that I wanted to discuss. And one is this fascinating piece of your interest in this Carter Report in 1967. So there was this proposal for tax reform in Canada. Can you talk about how you became involved in the study of that?

03-02:07:48

Harberger:

[laughter] Well, that's an interesting thing. I don't know how I ever got linked up with Canada. But I believe that apart from my time in India, which was a little tricky—we were in the MIT Center but we were consulting with the Planning Commission. Now, if you take all those days as me working with the Planning Commission, that is my biggest government help of my lifetime. But if you set that one aside I have worked more days for the Canadian government than any other government. And how did this happen? By the sheerest of accidents. My student Glenn Jenkins, who had been involved in project evaluation stuff, was a Canadian himself and it was maybe through him that I was first asked to come to Canada. And I think that was supposed to be for the Department of Regional Economic Expansion. And then came later the department of transportation or something like it. I don't remember the exact name. Then what would be their treasury department, Finance. And I think I worked for four or five different agencies of the Canadian government, but mostly with the same Canadian people because they have this scheme whereby the top civil servants bounce from department to department over their lifetime, and thus get a very rounded view of government and are supremely good civil servants. And so I worked with these people, the same people, in four or five different agencies of Canadian government. And half the time Glenn was also there, half the time he wasn't there.

But in any case, it was as a consequence of those connections that when the Carter Report came out, I was asked to be part of a conference on the Carter Report, which may or may not have been financed by the Canadian government. I think it was a purely academic thing. And it ended with a conference volume in which my paper on the Carter Report, of which it was a part. So the Carter Report itself was a magnificent reprise of the best of the economics of taxation that you could find in the tax literature, taking into account the theoretical structure and also the practical implementation aspects of the various taxes that could be imposed and which ones should be a part of a well-designed scheme and which ones should not and why in each case. So that was just wonderful.

But there is a kind of footnote to this story, which is that when, it was in late '73 or early '74, the new government in Chile was trying to reform the tax system, Juan Carlos Mendez, who was one of those three students that I

mentioned earlier, was working in the government. Either he was then already budget director or was later to become budget director for a long period. In any case, they were making tax reform at this time. And he called me up and wanted me to tell him how to get ahold of a copy of the Carter Report. And I searched high and low for a copy of the Carter Report. We didn't have internet at that time. We couldn't find one. It wasn't available direct from a publisher at that point. In any case, I ended up sending him my copy of the Carter Report, which in turn formed part of the basis of the major Chilean tax reform that took place at that time.

03-02:13:00

Burnett: Do you know what impact it had on the Canadian tax system? Were elements of that suggested report—

03-02:13:10

Harberger: I never made a direct follow-up to say, "This and this and this and this." It's not a part of my persona to do that. But I definitely feel confident that it had a profound influence on Canadian taxation, yeah.

03-02:13:34

Burnett: And one of the things that I noted in the report, you mentioned that Joe Pechman did an analogous analysis. He took that report as inspiration for an analysis of what it would do for the American tax system, which I find interesting because some of his suggestions then get bumped up the stream to the Reagan Administration and that becomes part of the '86 tax—

03-02:14:02

Harberger: Tax reform, right.

03-02:14:02

Burnett: —reform. So there are these connections here to this period of academic research that leads to genuine reform in at least three countries.

03-02:14:13

Harberger: Right, right, right.

03-01:14:16

Burnett: You're as effusive in the paper as you are now. I was interested in it in part because I don't think I've ever seen you so excited in print about something. [laughter] You were so effusive about this project. So there's something that really struck you. It seemed to make the most sense of anything that you had read as a policy document.

03-02:14:46

Harberger: That is correct. I don't believe that there is any recommendation in the Carter Report that does not have ample antecedents in the literature of economics. But the idea of looking at a whole package of taxes, looking at a tax system and saying, "What we're going to do is to try to reform this tax system. We're going to take it from here, where it is, and put it to here, where we think it should be." That was just wonderful.

03-02:15:28

Burnett:

Yeah, it was exciting. It made you think about perhaps what was possible in other places, as well, if not immediately in Canada. Sounds like it didn't take root quite immediately. So speaking of government research or consultation, there is mention of your work for the Department of Treasury for the United States government and the Department of Commerce. I think you wrote a couple of reports for them in the early sixties.

03-02:16:06

Harberger:

Yeah. Yeah. Well, the Treasury thing was—I will tell you the scenario and then you can figure it out. The Treasury Department, through various presidencies, Republican as well as Democratic, had evolved the practice of enlisting a certain, maybe twenty, maybe fifteen, well-known public-finance economists as Treasury consultants. And we were invited to Washington once or twice or three times a year, paid our expenses, and given a modest honorarium and invited to lunch in the Treasury with all the factota. [laughter] And being subjected morning and afternoon to a steady brainwashing of whatever it was the Treasury was doing. My take on this was that these meetings were mainly decided to blunt the barbs that we would later throw at the Treasury rather than to seek our well-needed advice in what they should next do. I don't remember any of those meetings at which the fundamental thing was, "What do you guys think about this?" [laughter]

03-02:17:56

Burnett:

[laughter] So it was some backroom propaganda essentially.

03-02:18:01

Harberger:

So the idea of the consultants being consulted—

03-02:18:10

Burnett:

Okay. So that's interesting. And we'll follow this up later.

03-02:18:17

Harberger:

Now, the Commerce Department thing, I think the things that I did on border tax adjustments or something like that, a couple of studies. I think they are in the taxation and welfare book but, in any case, they are in the bibliography. They were basically new economics, so to speak, at that time. It was on an issue that maybe is not the most incandescent in the field of economics. Border tax adjustments are the following. That if you have an indirect tax and you're importing something, that may be subject to a tariff or it may not be subject to a tariff but the country is allowed, under the GATT, now WTO rules, to add an excise tax onto the thing, so that the imported item pays the same tax as the domestic item, on top of whatever tariff there might be. And by the same token you have this domestic tax being assessed at the level of the producer. That tax then gets rebated upon export of that good. So the export good does not have to pay the tax. Now, this business of taxing the import good to match a tax on domestic production and untaxing a good that has been subjected to such a tax when that good is exported, those are called the border tax adjustments. And the question is what is their economic impact and how

should one look at those issues? Are they something that should in principle be applied or are they something that should be applied carefully only in specific circumstances and things like that. Well, I tried to do this analysis in sort of a general equilibrium framework in those couple of papers and they're kind of boring but they do deal, I think, analytically with this problem.

03-02:20:50

Burnett:

Yes. Speaking of transaction costs. So one other important piece in the end of the sixties is that you are a consultant for the Council of Economic Advisors and that's during the Nixon Administration of '69 to '74. You are free to talk about that as much as you would like. I realize this might not be the most important part of your career but—

03-02:21:24

Harberger:

I don't have a very clear memory of that but for one thing. I had this Latin American student named Ruben Almonacid, and he was, I think, as close to a genius as I ever recognized at the student level. And he wrote a thesis which really foresaw two decades of development of later modern macroeconomics. And I was so impressed by that thesis that I called the Council and I said, "You have to have this guy come out and present his material." And that's what happened. I went and Ruben went and presented his material and it was very well received. Paul McCracken was chairman of the Council at that time. And we went back home. We worked with Ruben for a long time. He was from Argentina, from Tucumán. And when he graduated he got a job at Vanderbilt. And Vanderbilt had a program in Latin America somewhat similar to what we had in Chile and Argentina and he was deputed to the University of Sao Paolo, I think, as part of the Vanderbilt program. And since this was a program financed by USAID he had the right to import a vehicle. And he imported a Mercedes. And he wasn't supposed to sell this Mercedes until he left, so to speak. But there were ways in which you could alienate the use of the Mercedes. The Coase theorem. [laughter] Permitted him to receive cash. Okay, with that cash he started speculating in land and so on and he ended up to be an important billionaire in Brazil. There was a town, I'm thinking of San Roque but it might not be the right name. Anyway it was a suburb of Sao Paolo. And in the agricultural land surrounding San Roque, San Roque, it was called, he owned about 10 percent of that agricultural land. There was a single tower, a multi-story building in San Roque. He owned that building. He had something like twenty or twenty-five separate enterprises. But he had no real office. He did most of his work from his car. And he did share an office address with another guy, like one room, but in the end he died of brain cancer with several billion dollars' worth of assets. Just an incredible person. And he was tremendously insightful. Theoretical economist to start and it was just crazy. But he had a fatal flaw, in a way. That he, in explaining something, it seemed, could only explain it by the way he had found it. He had to repeat his learning process. And where his learning process was not the same as his audience's, he didn't really register with the audience as he should. We paid him to come to Chicago and be a visiting assistant professor for the purpose of

taking his thesis and putting it in a more readable form. Didn't work. He lost a lot of money on that trip because he had to leave his empire in the hands of somebody else who didn't do very well.

03-02:26:41

Burnett: Oh, my goodness.

03-02:26:43

Harberger: [laughter] But anyway, that's the adventures of a Latin American *padrino*.
[laughter]

03-02:26:58

Burnett: That is absolutely fascinating. It's funny that you're telling this story about this one person that's so dramatic. I was hoping that a question about the Council of Economic Advisors between 1969 and '74 would provoke all kinds of reflections.

03-02:27:12

Harberger: No, I didn't do much consulting. That's the plain truth. It was a matter of days. And I don't have any clear memory.

03-02:27:23

Burnett: We can pan out from the Council of Economic Advisors to the period of the Nixon Administration. This is dramatic stuff. Chicago is really a part of that story in some important ways that are pretty obvious. There's Milton Friedman's anticipation of stagflation, in print before it happened, and there's George P. Shultz all through, in three different top posts in the cabinet. And there's going off the Bretton Woods system, developing the floating exchange rates. Can you talk a little bit about that time, those events, what it looked like from your perspective? Was it peripheral to what you were doing or were you and others at Chicago talking about this and what was going to happen?

03-02:28:22

Harberger: Well, I think the departure from Bretton Woods was a major event and something that many of us had anticipated. My image was that the gold was being drained from the US and our economy was growing and the rest of the world's economy was growing and somehow the gold stock was not going to be adequate at those parities to sustain the proper money supply. So the idea that we should break with the parity and move to a flexible exchange rate and have the others move to a flexible exchange rate I think was exceedingly healthy. Mundell would disagree with that. Mundell was a firm fixed exchange rate person. I think history tells us that in normal times, and we have many country experiences to prove this or to sustain this, a fixed exchange rate system works exceedingly well and probably better than a flexible rate, where you don't have to worry about what will be the rate next December or next January or whenever you have to make a payment or whenever somebody's going to pay you, and all of that. That a certain level of uncertainty is eliminated. And it really can work.

Mussa, at the close of his stay in the IMF, maybe five years as chief economist, they had a big Mussa fest, a three-day conference in honor of him. And he made various and sundry comments as different papers were presented and so on. But the one that sticks with me is his capsule of the virtues and vices of a fixed exchange rate system. He says, “When things are going well a fixed exchange rate system sings like a bird. And when things are going badly it shits like an elephant.” I think that tells the whole story. Greece is experiencing the elephant. Spain, Portugal, Ireland, periods of their—

03-02:31:44

Burnett:

Crises.

03-02:31:45

Harberger:

—crises in these recent times. That’s the kind of thing that happens. Huge unemployment rate, misery, and so on. And with a fixed exchange rate you don’t have a way to fight it. And people talk about the downward rigidity of wages and things like that. That lies, in a way, at the root of this. But I think experience tells us that countries that are able to devalue at such a time get off a hell of a lot easier than the countries that can’t do that. And that’s the big message. So if you are betting, betting, betting on the times being good and the system singing like a bird, well, then, you really buy into a fixed exchange rate. Panama is a wonderful example. Well, how does Panama get to be so prosperous and so continuously prosperous with a fixed exchange rate system, a developing country? Panama Canal. Canal zone revenues are steady. They may go like this, up and down in good and bad times. There are somewhat fewer ships going through the Canal and so on in bad times than in good but nothing like the huge swings of, let’s say, hundred and fifty at the top and fifty at the bottom that are not uncommon for copper, lead, zinc, wheat, goodness knows what, but can be principle exports of a primary-producing country. So where Panama can ride through all sorts of international storms and not really get into trouble, the same has not been true of so many other countries. Well, most Latin American countries have experienced this problem and the recent ones that I mentioned. Greece, Spain, Portugal, Ireland. All got into fixed exchange rate trouble.

03-02:34:13

Burnett:

Right. And in the American situation, between ’69 and ’74, there’s obviously the wage and price controls and these policies were put in place by Nixon, against the advice of George P. Shultz and others who had the kind of background that they had, and Nixon had said famously, “We’re all Keynesians now.” He was very much a politician who responded to the expectations of the public. So there was that level of rigidity. There were people who had come to expect the government to act in bad times. I read this somewhere in your development policy primers, many of them that you’ve written. That part of the story is educating people about expectations. That’s a complete paraphrase of something that you’ve written. Was that influential, that period to you at all? What did you think about the end of the Bretton Woods system, the development of—

03-02:35:42

Harberger:

Well, I thought the end of the Bretton Woods system was something that had to happen and that when it happened I was pleased, not displeased. So that part was fine. There were issues connected with the oil price boom and bust of '74 and another oil price boom and bust later in '79, that maybe we can talk about at a later point. But what I remember from that period was the great pleasure I had in making two big trips with George P. Shultz. He made one trip to Latin America where we went to Venezuela, Brazil, Argentina, and Chile. And maybe we went to one or two other countries. But I can remember that in each of these places we had a reunion with former students of mine. We had kind of a Chicago party in Rio and another one in Buenos Aires and another one in Santiago.

03-02:37:26

Burnett:

With George Shultz?

03-02:37:26

Harberger:

With George Shultz, yes. And he was in seventh heaven to be with these former students from Chicago. And in the case of Chile, these were pretty high people in the government hierarchy at the time. I think I mentioned earlier that my students got to be undersecretaries and vice president of the central bank and so on in the first year and a half or so of the military government. And then after the Friedman visit, they bounced up to the top level. So this was in the earlier of those two phases. But Shultz was very proud of them and very happy and so on. That was the occasion where I accompanied Shultz on his visit to Pinochet and heard him lecture about various and sundry things, including human rights.

03-02:38:45

Burnett:

That must have been surreal. That's in '74, I think, right? And that would have been at the tail end of Shultz's time as—

03-02:39:05

Harberger:

That is correct, yeah. Then we went on another trip, though, to Asia. Would have been in the spring of that year. I was a visiting professor at Princeton the spring of '74. At Chicago, I had been teaching all my classes six hours a week instead of three, so that I could be absent at will almost throughout, and never cheat the students. But at Princeton they had this schedule of three hours a week and you couldn't diverge from that. And I had to actually pay a colleague to take my class when I went off on this trip to Asia with George Shultz. But anyway, we went to the Philippines, we went to Singapore and saw Lee Kuan Yew. And we went to Malaysia and Burma. The Philippines, Hong Kong. It was a wonderful trip.

03-02:40:32

Burnett:

And what was different? Because I imagine being entrained with the whole State Department apparatus, that's a different experience with a different perhaps reception. Can you talk about that difference from your regular forays with USAID, for example?. How was it different for you?

03-02:40:52

Harberger:

I don't see that much. I think Shultz wanted me along as a kind of an anchor to windward or something. That the pressures on this and that and so on, you get edged away from good economics some of the time. Each such step looks like a reasonable one and so on and you begin to lose perhaps a broader economic perspective in seeing what the ultimate issues are. Anyway, I thought that I was there mostly for that purpose. He had an assistant secretary, Jack Hennessy, who later became a high muckety-muck in the Wall Street and Boston financial community. So he and I were the two people who accompanied him to meetings with heads of state and so on. And for me that was a wonderful experience. That's what I really remember. How often do economists get the opportunity to be in these meetings with presidents of countries and great intellectuals like Lee Kuan Yew?

03-02:42:38

Burnett:

Yeah.. Well, follow-up on that. How was it meeting with Lee Kuan Yew?

03-02:42:47

Harberger:

Well, I think we should save that until we get to the nineties when I'm seeing Lee Kuan Yew at Stanford every year.

03-02:43:00

Burnett:

Okay, great. Let's do that. I think George Shultz's expertise is industrial relations and he's obviously a very smart man who's learned a lot about things that he's had to learn about. But your expertise in international trade and also perhaps your experience with, as you said, those kind of structuralist arguments about—I think you became an expert in that, having encountered the ECLA arguments over and over again. And so I imagine he's going to these places, as someone is giving him a speech about United States domination of markets or something like that, and it would have been refreshing to be able to debrief with you.

03-02:43:53

Harberger:

Yes. Well, I'm sure there was some of that in this process, although the Asian countries were not the great sinners. And in Latin America we were in pretty good periods in terms of economic policy in maybe all but Argentina. I think Argentina was in bad shape at that time.

03-02:44:25

Burnett:

Yeah, and heading into worse shape.

03-02:44:27

Harberger:

We had Roberto Campos in Brazil and in Chile we had Sergio De Castro and it was a happy time.

03-02:44:37

Burnett:

You mentioned earlier that you had consulted for Brazil—

03-02:44:50

Harberger:

With the Ford Foundation.

03-02:44:50

Burnett:

With the Ford Foundation for about ten years. During when to when? And what was that like?

03-02:44:55

Harberger:

Well, it was in the sixties. There was a fellow named Stanley Nicholson who was the Ford representative in Brazil and somehow he latched on to me as his economic advisor. So I went once or twice a year to Rio and they put me up in the Ouro Verde Hotel right on the Copacabana and so on. And I got to travel inland to see the various projects that they had in Belo Horizonte and Sao Paulo, in Brasilia. I learned a lot during that experience and I think the actual type of advice I gave was, "Give money to these guys and not to those guys." [laughter] It was not very hard to distinguish between at least what I thought were pretty good projects and what I thought were not so good. So we had this long time connection with Nicholson and it worked extremely well. And if I don't remember wrongly, there was one of our guys, a Chilean, Luis Arturo Fuenzalida, I think I mentioned he was the one man planning agency for President Alessandri, whose term was '58 to '64. The latter part of that term Fuenzalida was this one- man ODEPLAN [Chilean Ministry of Social Development]. And then later with the military government he moved to Brazil and he had some kind of a project with the Ford—he helped in a project which Og Leme ran that sent all the Brazilians to study in Chicago. The Center for Education and Development within Campos's ministry. Anyway, he was a consultant to that. And then with Ford Foundation help, he and another Chicago guy, Musalem, went to the university in Recife.

03-02:47:53

Burnett:

Oh, the Northeast. Yeah.

03-02:47:57

Harberger:

They set up a very solid and good economic program with Ford Foundation money.

03-02:48:08

Burnett:

That was the center of radicalism in the northeast of Brazil. There were all kinds of Marxist—

03-02:48:13

Harberger:

Some parts of it. Certainly the economic center of radicalism was the University in Campinas, which to this day seems to be the farthest left of all the main Brazilian universities.

03-02:48:34

Burnett:

What state is that in?

03-02:48:34

Harberger:

I don't remember.

03-02:48:37

Burnett:

Okay, yeah. And so this was during the sixties. So the Castelo Branco regime comes into power in '64, I guess, and then it's Costa e Silva in '67. So it's after that?

03-02:48:50

Harberger:

Yeah. Well, I think of the good times in Brazil coming with Roberto Campos as the leading minister. They are the authors of the Brazilian Miracle. And the Brazilian Miracle dates basically from '68 to '79. It is characterized by economic growth of 10 percent by year over that whole period. So it doubles in seven years. So in ten years it multiplies by close to three. So it was a great period for Brazil. These guys did a lot of things right and a few things not so right. But they get a very high grade when all is said and done.

03-02:49:44

Burnett:

Right, right. So that's a period that I wanted to cover with you. And I did want to go the academic side. You were talking about Princeton but you had two visiting professorships back to back. One was at Harvard, seventy—

03-02:50:13

Harberger:

Well, Harvard was '71, basically the fall of '71 and just into January of '72. It was one semester.

03-02:50:20

Burnett:

Oh, I see. Okay.

03-02:50:23

Harberger:

And then Princeton was two semesters in '73, '74.

03-02:50:27

Burnett:

And what was the occasion for that visit to Harvard? How did that come about and what was it like?

03-02:50:35

Harberger:

Well, I don't know quite the story. A, I was invited. I don't remember even if Ed Mason was still around at that time but Ed Mason was a very leading figure at Harvard, a key dean, and he had been a member of the president's materials policy commission and I had gotten to know him at that time and he had wrangled an offer from me to come to abandon Hopkins to go to Harvard as an assistant professor, which I wisely turned down. I turned that down because I was in some big meeting and at a certain point the assistant professors were asked to leave the room while the senior professors confabulated about something. And I said, "This would never happen to me at Hopkins. I was part of the decision-making body from day one as an assistant professor." And I had no urge to have that demotion of status that would automatically come going to Harvard. So anyway, Ed was always pushing my presence or something like that. Hollis Chenery had gone to Washington. His chair, so to speak, was at least temporarily empty.

Now, I don't honestly know if I was being thought of for that chair at that time or if I was just filling in for Hollis. But in any case, I was there for just one semester and had a good time and had a couple of Latin American students there who became key people in their own countries. Pepe Piñera in Chile and Adolfo Sturzenegger in Argentina. Adolfo Sturzenegger is the father of Federico Sturzenegger, who is maybe one of the next ministers. But this new government in Argentina, Macri's government, Sturzenegger was the key economist in that campaign. And Federico, the son, was the other. Federico, in turn, had come to UCLA as an assistant professor and he did me the honor of sitting in on my project course from beginning to end while he was on the faculty. So as he could get the word from the three basic postulates. [laughter]

03-02:53:51

Burnett:

On your three-by-five card. [laughter] We'll go through the Harvard record and find out what really happened in terms of the nature of the appointment. But you had a full year at Princeton.

03-02:54:14

Harberger:

I had a full year at Princeton, yeah.

03-02:54:14

Burnett:

And what was that like?

03-02:54:17

Harberger:

Well, I mean, I was from New Jersey. My parents were living twenty miles from Princeton, so I got to see a lot of them. We had a very fine time. People came up from Washington to visit. I got to meet PPK, Pedro Pablo Kuczynski, who is a perennial presidential candidate now in Peru. But probably of the recent period, he is the key positive person in economic policy in Peru. And we became friends when I was in Princeton and he was working in New York but living in Princeton. And we cominged in social gatherings and became good friends.

03-02:55:17

Burnett:

It sounds like you have this Latin American connection wherever you go. You go to Harvard and you meet these Latin Americans.

03-02:55:28

Harberger:

Well, it's because of the "it takes one to know one" kind of thing. That I was into Latin American economics in a serious way, trying to diagnose the situation and see its special characteristics and thinking about economic policy in those terms. And that was something that smart Latin Americans studying economics tended to gravitate to. So we got along very well.

03-02:56:14

Burnett:

Yeah. Do you speak Spanish? You read Spanish, of course.

03-02:56:17

Harberger:

Of course I speak Spanish.

- 03-02:56:18
Burnett: Yeah. And do you speak Spanish with them or does it depend on the context?
- 03-02:56:21
Harberger: Well, Spanglish, probably. That's what happens. When you find that you want to make a one-liner, sometimes the English one-liner is the right one and sometimes the Spanish one-liner. It comes like that.
- 03-02:56:41
Burnett: By speaking to people in their own language, do you find that there's a different level of communication?
- 03-02:56:50
Harberger: Yes. You know, if somebody says, "Buenas tardes. ¿Cómo está usted?" that will set the situation in ice.
- 03-02:57:19
Burnett: Yes.
- 03-02:57:19
Harberger: But if you can express yourself colloquially so that they see you as having absorbed something of their culture; that is a very different situation.
- 03-02:57:33
Burnett: It is.
- 03-02:57:33
Harberger: And certainly with respect to most of the Latinos that I have interacted with, that's the basis on which we got on so well.
- 03-02:57:45
Burnett: It's not a feature that we have discussed so far but in terms of cultural connections, with technical assistance there wasn't always this concern. That was the problem. Later there became a concern that there was this paternalist top-down—
- 03-02:58:07
Harberger: I call it instant expert.
- 03-02:58:09
Burnett: The "instant expert phenomenon." And your approach early on seems to be that you developed a social connection, a cultural connection with many of these folks.
- 03-02:58:25
Harberger: Yeah. And a perennial aversion to the role of instant expert. The idea that you can come from a foreign country and set yourself down in an environment and say, "I know the answer to your question," where smart people have been knocking their heads for a decade on this subject and you have the answer on your three-by-five card. No way. So I think I may have said this before, but nothing has served me better than to say, "No, I can't answer that question

until I have studied it adequately.” And even to say such a thing is a big door-opener. That they look upon you in a different way, than to say, “Here’s another one.”

03-02:59:27

Burnett:

Right, right. So we’ll amend it to the three-by-five with the three postulates plus.

03-02:59:32

Harberger:

Well, no. Three-by-five card with three postulates isn’t supposed to give the advice. Well, what I’m saying is just as plain and solid geometry derive from a minimum number of axioms up here and all the rest follows, you see, there is this huge complicated detailed structure that happens and what’s so fascinating is that those three postulates are a sufficient base to have that whole intellectual structure.

03-03:00:14

Burnett:

Right, right. Well, before we go on, I do want to talk about the Chicago economist as international consultant. There’s one more piece in the early seventies, a role that you served on the executive committee of the American Economic Association from ’70 to ’72. And I’m wondering if you have any comments about the climate in the American Economic Association, in the early seventies. For example, I’m thinking of the election of Galbraith to president for ’72, I think. So I guess ’68 Milton Friedman was president, I think. I think. Maybe ’69. And then Galbraith is president. So you have these kind of two poles, if you will.

03-03:01:18

Harberger:

I don’t think that Friedman got it because he was free market.

03-03:01:33

Burnett:

Oh, no. No.

03-03:01:35

Harberger:

And I don’t think that Galbraith got it because he was anti-free market.

03-03:01:42

Burnett:

No.

03-03:01:43

Harberger:

I think that each of them got it because, A, they had made their mark, that they were known as people who have seriously contributed to the literature of economics. Okay. That is step number one. And step number two, they are not kooks. The presidency has responsibilities. You don’t get to be president just being present. You have to be president-elect before you’re president. And when you’re president-elect you have to organize 500 sessions of meetings at the annual meetings of the Association. And that’s a big fat job. And if you have some flaky guy up there, however smart, we’re not going to trust him with that task, you see. So it has to be somebody who has evinced sufficient responsibility to take on this big job. And I would say, additionally, to give a

respectable presidential address. Those are the two big tasks of the president and I think both Friedman and Galbraith fit that role perfectly well, even though they're on opposite sides of a chasm.

03-03:03:28

Burnett: Right, yes.

03-03:03:30

Harberger: Did I talk about Galbraith in India?

03-03:03:32

Burnett: No, I don't think you did.

03-03:03:35

Harberger: Okay. He was ambassador to India—

03-03:03:36

Burnett: That's right.

03-03:03:37

Harberger: —when we were there.

03-03:03:37

Burnett: That's right.

03-03:03:39

Harberger: And Anita and I were invited to lunch with him and his wife every other Wednesday as long as I was in town and he was in town. And this was a regular thing all through his stay. And he was more free-market economics in India than he ever was in the United States. And he was sensitive, at least, to the degree to which Indian policy had strayed from sensible supply and demand, so to speak. And he was pretty good at that. But I thought this might vaccinate him, kind of, so that when he came back to the United States he wouldn't revert. [laughter]

03-03:04:37

Burnett: No such luck?

03-03:04:38

Harberger: But no such luck, no.

03-03:04:42

Burnett: Yeah, it sounds to me from everything I've read, he was certainly a scholar that you could have a conversation with no matter what, and that he was perfectly willing to entertain various points of view respectfully, except sometimes in the press he was not so respectful. So I think the only reason I asked that question is I read something, some description about the climate of the meeting in '72 or '71 when he was president-elect and there was a description that there was a sense of uncertainty about the future of economics in the seventies, and maybe this was a bit of purple prose about what was

going on, but that there were young economists with long hair who were kind of acolytes of him. So I don't want to—

03-03:05:46

Harberger: Yeah. I can believe that but I have no memories of it.

03-03:05:51

Burnett: Right, okay. And just to close off this period in terms of your role as an economist at the University of Chicago. The political climate of the 1960s at Chicago, is there anything that struck you, the climate on campus? Of course, the Vietnam War. There's the Great Society. There's burgeoning inflation. So much is going on. Were there any recollections that you have that were notable from your—

03-03:06:29

Harberger: Well, I have to tell one story. Since this is an oral history not just of economics at Chicago necessarily. But Hutchins had banned football at Chicago. We were Big Ten before Hutchins but during and after Hutchins, zero football until Larry Kimpton brought it back sometime in the fifties. People made jokes that we were playing some girls finishing school in football. But anyway, I remember very definitely, at this very time, that I was walking past Stagg Field, Stagg Field under which the first nuclear reaction had taken place.

03-03:07:35

Burnett: Yes, for the Manhattan Project.

03-03:07:37

Harberger: It had only one rack of bleachers and the other side was open to University Avenue. So as you walked along University Ave and you could see this rack of bleachers in the background and between you and the bleachers was the football field. So anyway, I decided I was going to watch a little football, so I went around and I started watching this football game. And all of a sudden, these people with long hair and scraggly beards on were the cheerleaders. And what was the cheer? "Ho, Ho, Ho Chi Minh, the U of C has got to win." [laughter] Doesn't that capture the year?

03-03:08:28

Burnett: That might do it, yeah. I'm sorry, there is one more piece I'd like to ask. May go nowhere. But D. Gale Johnson was Dean of the Division of Social Sciences during the time that you were—

03-03:08:45

Harberger: Chairman.

03-03:08:48

Burnett: —chairman of the department and then he succeeds you as chairman of the department.

03-03:08:52

Harberger:

Yeah, yeah.

03-03:08:54

Burnett:

Yeah. So did you have regular contact with him administratively, conversations about the direction of the program?

03-03:09:05

Harberger:

Well, I mean, he was a member of the department. He came to department meetings. And the way things worked on salaries, the chairman would make a proposal to the dean and the dean would look at that and he would make whatever changes he thought appropriate and then it would pass up to the provost and then it would bounce back down again. So I had those contacts with the dean all the time. Then whenever anybody got an offer you had to make a response and it was the same process. What can I say? Let's say I don't remember when the big grant from the Ford Foundation supporting general workshops in Chicago came. I don't even remember if it was during my chair years or not. But what I do know is that Gale and I were both there in the department meetings in which these happened. And there wasn't any big special thing that had to happen between the administrative branches, so to speak. Everything was very straightforward. We welcomed this money. It didn't come with any strings, and bang, bang.

03-03:10:59

Burnett:

Right, right. So let's turn to just beginning to talk about the 1960s as the development decade. So this is—

03-03:11:11

Harberger:

The sixties.

03-03:11:12

Burnett:

Yeah. This is your time as an international consultant. We talked about your time in the department. And we talked a little bit about some of the bugbears that bothered you, that animated you, the zero marginal productivity of agricultural labor, ECLA, and that kind of stuff. And I guess I want to ask you an open question. We can handle it one or two ways. I'm wondering if you can say more about *bad* development economics. If Chicago economics is good economics, what constitutes bad economics that you were encountering in addition to the ones we've already discussed, that really bothered you that you wanted to handle?

03-03:12:16

Harberger:

Well, I'll give you two stories. One is when I was in India and we were in this MIT project and we had Dick Eckaus from MIT and Per Sevaldsen from Norway and [Beniamino] Andreatta from Italy. Was there another one? Anyway, there came during that period another guy from MIT whose name escapes me. But he was one of these big model builders with many sectors and input/output relationships and all of that. And here he had this big fat mathematical model which had in each sector of the economy zero

substitutability between capital and labor. Well, that was very common, that most of the big models were made that way. And this struck me as so crazy. If you had a little model with free substitutability and all, not infinite, not zero, but somewhere in between, and variably in between, I mean, where you could set the model up so that that elasticity was one or two or three or five or half. Why they didn't go that way, you see? And how this single crazy assumption, which was of great mathematical convenience, so distorted the end result that it was virtually worthless. That is the number one example of the kind of thing that I didn't like and didn't think was good economics.

The other example came from a very sad event, in a way. Paul Rosenstein Rodan was the key figure in MIT at the time of my visit to India. I'm 100 percent sure that he had been instrumental in me being invited. Max Millikan was the administrative head. He may have helped but Paul was surely the one behind that. Well, in the [Eduardo] Frei administration, in the late sixties—Frei was succeeded by Allende in '70, so we know it's the late sixties—there had been a Ford Foundation financed MIT team in Chile's planning office. And a committee was named consisting of myself as chairman, Jorge Cauas, who later first president of the Central Bank, and then super minister. But Jorge Cauas and Dick Mallon, who was on the Harvard DAS program at that time, later HIID. So Mallon, Cauas, and I were this committee and we were supposed to evaluate what MIT was doing in planning in Chile. And we wrote what I believe was a very scathing report on what they were doing. And if you want the one-liner or two-liner about that report, was they had to be thinking that they were writing articles for the *Journal of Economics and Statistics* or the *Journal of Development Economics* in England or something like that. And they weren't really trying to diagnose what was wrong with the Chilean situation or really trying to fix it. So they were making a short-run model of the Chilean economy, a medium run model of the Chilean economy, a long-run model of the Chilean economy. And what message were they trying to derive from this? Well, it didn't matter for our message. They had the model. Isn't that beautiful, you know what I mean? That kind of thing. And so we really gave them hell for that. I can remember Paul Rodan in one of the sessions where we were presenting this material in Chile and he was there. And he said, "Well, that can be taken care of in our medium-term model." [laughter] You know, that kind of thing. It was really terrible.

What did they not do? They did not at any point analyze the huge tariffs that they had on international trade, the other main restrictions that they had on international trade. The so-called effective protection. You know what effective protection is? It's bad enough if you have an activity that's protected by a 50 percent tariff, but the value added will be protected by a 50 percent tariff only if you also have a 50 percent tariff on the inputs. Otherwise you multiply that effective protection by having a zero tariff or a small tariff on the inputs. They never studied any of that. Where this was the most obvious thing that was wrong with the Chilean economy. And we just gave them hell.

- 03-03:19:03
Burnett: And inflation in Chile at that time was already a problem, was it not?
- 03-03:18:09
Harberger: I think we talked about the AID project, where we combined with Carlos Massad and Sergio Molina. Did I talk about that?
- 03-03:19:28
Burnett: The 1965 project?
- 03-03:19:33
Harberger: Yes, roughly '65. Sixty-four, sixty-five. I was the chief economist of an AID mission to Chile to define the long-range assistance strategy. Did we talk about that?
- 03-03:19:54
Burnett: No, we hadn't. I thought I might save that for our session on Chile specifically tomorrow but we can talk about it now.
- 03-03:20:20
Harberger: Okay. No, no, that's fine.
- 03-03:20:03
Burnett: But all this to say that this is the MIT Center for Study of International Development.
- 03-03:20:12
Harberger: Center for International Studies it was called.
- 03-03:20:15
Burnett: Center for International Studies, right. CENIS, I guess. And these are some of the original, like Paul Rosenstein-Rodan, his 1944 paper that led to the notion of balanced growth. So these are the big gurus, right, for development. I wonder about the initial decision that Theodore Schultz made to hire you in public finance, to do public finance but your background is international trade. Do you think there's something about having this background in this one track, that you're tuned into questions of international trade that these other people were not thinking of? Or is that too simple?
- 03-03:21:04
Harberger: Well, let's say I and a fair number of other people—now, Anne Krueger is one, but Anne Krueger had a background in international trade, too. But, for example, Malcolm Gillis is another and Malcolm's background was in public finance and not in international trade. But his great work was in Indonesia where he was possibly one of the most successful foreign advisors that I know of. And the basic point is that people whose economics was basically market-oriented economics got these things straight more or less by themselves. They all understood that 200 percent tariffs were stupid and hurt the economy. Doesn't take a great many courses in international trade to know that. But when you get to what was happening in that MIT thing in Chile, they were

playing games, making models, and passing over the chance to criticize very dumb things that were being done, as if they didn't see them. And being very proud of the things that they did. That was the problem.

03-03:23:15

Burnett:

Right, right. I think there was a technological enthusiasm at the time. There's a book by an author whose name escapes me at the moment that's just been published about the design team that developed the command center for Allende's planning ministry. And it looks like the bridge of the Starship Enterprise. For the five sectors of the economy it has five computer consoles with printouts. But what emerges in the story is that they didn't have the data to put into the computers. So there was this sense that they wanted the cutting edge and the most sophisticated processing without attention to the underlying availability of data or some of the basic assumptions that you were talking about. [Eden Medina. *Cybernetic Revolutionaries: Technology and Politics in Allende's Chile*. Cambridge: MIT Press, 2011]

03-03:24:07

Harberger:

Yeah. It's another thought that probably has no obvious place in our conversations. I had a grant from the NSF, I think it was my only grant from the NSF. The title was something like "exploring medical and biological analogies in economics" and the idea was that as wounds heal themselves, so shocks to the economic system produce their own healing process and so on. This sense of a self-correcting mechanism that straightens itself out if screwed up and so on, I think people who think that way tend to get things more right than people who think in a strictly mechanical way. And I believe that these modelers, both the ones I was criticizing, the one on India and what they were doing in Chile, the same, well, they were very different types of models. They just weren't informed by this medical or biological analogy.

03-03:25:58

Burnett:

We spoke earlier about ECLA but that gets a new life with—and we'll talk about this next time, I suppose—but the development of underdevelopment—those kinds of Marxist or quasi-Marxist arguments about the structural problems with underdevelopment having to do with international trade creating those conditions in the first place. I imagine at some level, certainly not at MIT, but at some level the reception to those ideas was at play in many of these countries.

03-03:26:39

Harberger:

Well, don't kid yourself. To so-called two-gap model was created by none other than Hollis Chenery.

03-03:26:42

Burnett:

Can you talk about that a little bit?

03-03:26:46

Harberger:

Well, the two-gap model was the savings gap and the trade gap. What is true is that there is this wonderful triplet, so to speak, in macro-economics, that if a

country imports more than it exports, M minus X , it has to be demanding more tradable goods than it is producing and that gap has to be the same as the trade gap. And then there also has to be the corresponding gap between aggregate demand and aggregate supply. So you're living beyond your means by the amount that you import more than you export. Well, those three things have to be equal *ex poste* but *ex ante* they're determined in different ways. So this is determined by savings and this is determined by trade. The exports minus imports. And now the question comes. Suppose the trade gap is 10 percent of GDP and the savings gap is 5 percent of GDP. Well, which one of them is going to win? And one of them is going to be the critical gap and aid should finance that critical gap because otherwise the economy will fall short of full employment. Something like that. And so there were stories that if the trade gap is the critical gap, each dollar of aid will produce five or eight dollars of GDP in the country. [laughter] If it's that easy to produce five or eight dollars of GDP in the economy, wow. [laughter] Just give me a little piece of that. So anyway, that kind of rigid thinking was widely present at that time.

03-03:29:32

Burnett:

Yeah, and overconfidence in the ability to—

03-03:29:38

Harberger:

Yeah. And people were building planning models in Colombia on the basis of these models.

03-03:29:45

Burnett:

Right, right. By the early seventies you're publishing general essays, advice about how development should go forward and you're commenting on this period. It seems like by the end of the sixties folks have learned some basic things. The industrial fundamentalism of—well, this is something I meant to ask you about actually. You're there in India in '61, '62 and the first test plots for the new Norman Borlaug seeds and the Rice Research Institute, that's coming online a year later. And then *Transforming Traditional Agriculture* comes out in '64. Was there any hint on the ground? Was it all industrial fundamentalism in India at that time? Was there any hint on the ground about modernizing agriculture with American agricultural extension?

03-03:31:15

Harberger:

Well, I certainly believe so. Did I tell you any stories about Mr. Nathan and our office in India?

03-03:31:34

Burnett:

No, I don't think so.

03-03:31:36

Harberger:

Okay. Well, the MIT office was there in Chanakyapuri. That's the diplomatic quarter. And we had this Madrasi Brahmin named Mr. Nathan as our office manager. Well, I'll go back. There was this issue of the unemployment, the fact that the lowest rate of unemployment was among the illiterates. And this

was noted by the World Bank with a footnote, “They can’t afford to be unemployed.” This was absolutely true. They had to take anything that was available. And I found that the landless laborers worked 250 or 200 days a year. So it was all clear that those guys were working. And the highest unemployment was among recent graduates. Well, I developed this model of the protected sector and the unprotected sector in labor markets, where the protected sector are the good jobs that pay high wages that have to be sustained somehow. It can be a minimum wage. It can be a union wage. It can be the Dow Chemical paying above average wages in order not to be subject to all sorts of complaints that they’re paying higher in the United States than they are here. Any of those reasons can cause this protected sector to exist. And then you have a gap between the protected wage and the unprotected wage coming about.

Well, we, every now and then, had to hire people in connection with our project and a steady stream came through Nathan’s office. And I told him that anytime anybody came he should look into my office and if I wasn’t busy, to send the guy in after he was finished with him. So these people would be coming in and some of them were middle school graduates. Some of them were college graduates and so on. And I would always open the newspaper. They had an English language financial thing with “help wanted.” And we would go down the “help wanted” listings and say, “What about this job? What about that job?” And it was always, always ready. I can’t remember a day when we did this that there wasn’t an advertisement for somebody to be a salesman for a pump irrigation company, to just walk around farms and try to persuade the farmers to buy irrigation pumps and install them. Well, I didn’t have a single interviewee that wanted to be a salesperson of irrigation pumps. That was sort of beneath them. That they were not going to sully their hands with that kind of stuff. But then I would say, “Where do you want a job?” And they would say, “Well, how about the American Embassy? How about the British High Commission?” They’re a protected sector. “How about the foreign service of the Indian government or the Indian government in general?” That was a protected sector and they liked that and they were looking for that. So I’d say, “Here. Here’s one from the Indian government.” They always seemed to want some educated person to go to live in a village and to be the instrument of bringing modernization to that village, to facilitate modernization and so on. They’d say, “What? Me live in an Indian village all by myself?” [laughter] “Unthinkable.” These were mainly Brahmins.

B3-03:36:24
Burnett:

So there were some caste and cultural—

03-03:36:26
Harberger:

You couldn’t do that. But the fact that those advertisements were there is evidence that the Indian government was definitely into the process.

03-03:36:37

Burnett:

That's interesting. So I guess one of the things that happens is that the Green Revolution takes off in India and it begins to produce dividends in terms of agricultural productivity. And so that probably gives a bit of a boost to the Schultz/Harberger/Johnson argument for greater investments in agriculture and probably brings to somewhat of a close the Arthur Lewis argument about disguised unemployment by the end of the sixties. Would you say that that's fair?

03-03:37:16

Harberger:

Certainly. Everybody was aware of the Green Revolution by the time it had already happened. [laughter]

03-03:37:26

Burnett:

Very true. I don't know. I don't know if it would be a given that the zero marginal productivity of labor argument would necessarily die because of the Green Revolution.

03-03:37:41

Harberger:

Oh, no. Well, it never did. There were always those who either explicitly, whom I blame more, or implicitly, whom I blame only slightly less. But the ones who made mathematical models that simply incorporated that assumption without trying to say, "Well, we really have this and this is the reason why." As I may have mentioned, I was always ready to accept zero marginal product for the middle-income farmer who didn't want his relatives to be hired out as somebody else's hired hands. And that was a social snobbery kind of issue and certainly was not massive in such a way that you could say, "You can count on this unlimited supply of labor," which is the Arthur Lewis argument.

03-03:38:38

Burnett:

Right. It seems like, at least in the United States, there was an enthusiasm, optimism about development at the beginning of the 1960s. What's the portrait look like by the end of the 1960s?

03-03:39:03

Harberger:

Let's say by the end of the 1960s the Brazilian Miracle was just starting. So those of us who were familiar with what was going on in Brazil were enthusiastic. In Chile the incipient good economic policy of the first years of the Frei administration had been beaten back by the left-wing of the Christian Democratic Party. So they were goofing off around land reform and spending too much money on housing and doing this and that and reigniting the inflation, which the first part of the Frei administration had brought under significant control. So things weren't looking so great there. In Argentina I don't remember exactly. My Argentine history isn't that good but I don't think anything good was happening in Argentina at that time. Mexico was not in good shape at that time. Mexico had Echeverria, I think it was.

03-03:40:55

Burnett: So there was a need to re-evaluate for some?

03-03:41:00

Harberger: No. Let's say our guys had a lot of answers but few successful applications. We didn't have on-the-ground successes to point to as we did ten years later.

03-03:41:22

Burnett: Right, right. Well, let's leave it at that and we'll take it up next day.

[End of Interview]

Interview 4: December 1, 2015
Session 4A, Morning

04-00:00:00

Burnett:

This is Paul Burnett interviewing Dr. Arnold Harberger for the Economist Life Stories Project with the University of California Berkeley Oral History Center and the Becker Friedman Institute of the University of Chicago. And this is our fourth day-long session and this is the morning session, December 1, 2015, and we're here in Chatsworth, California. So we are continuing our conversation about the development decade. But I think this morning we're going to focus on continuing an earlier conversation about the Chile Project that began in 1956. And I think we got up to talking about the training of Chilean and other Latin American economists in the University of Chicago and a little bit about the beginning of the training, the contract with Catholic University in Chile. So we got up to about 1962, '63, as I recall, and talked a little bit about Argentina. So can you take it from there? Tell us about at the beginning of the 1960s how the program was doing, how it was being received, what kind of problems you encountered.

04-00:01:34

Harberger:

Okay. Well, as I already mentioned, Catholic University really took seriously the requirement that they hire people trained by us as full-time professors and they also hired Ph.Ds from other universities as full-time professors. So, as I mentioned, I think by the end of the phase-out project in '64 they had something like thirteen full-time professors where they were only required to have four. So that shows that they were taking up their responsibilities with considerable enthusiasm. And, as I also mentioned, those first cohorts of trainees on the Chile Project were so exceptional. We had no basis for expecting them to be so good and to have such leadership and teaching capacity qualities as they did have. The number of them who went on in life to play very important roles in the governmental arena, in the academic arena, in the international forum kind of arena, it was just fabulous. So things started out going extremely well.

There began to be some troubles on the scene with the appearance in Chile of Padre Vekemans. He was a Belgian Jesuit, I believe. And he came and formed a sociology center parallel to our center. And the purpose of his presence there, in one way or another, was to forestall communism in Chile. When people talk about linkages of the Catholic University to the CIA, I know of none. But I have good reason to suspect that Vekemans's money, which was said to have come from European bishops, may have come from another source. And I only have one little link, that one time when I was in Washington on a totally different mission, I think I was visiting the Treasury Department. It was some major place anyway. All of a sudden I see Vekemans walking around. And there was no knowledge within Chile that Vekemans ever visited Washington. So the notion that there was some sort of a connection there was present.

Well, the interesting problem is that while we were financed by what later became USAID, maybe this antagonistic entity within the Catholic University was also being financed by US money and was pulling in the opposite direction, so to speak, and trying to out-populist the—

04-00:06:30

Burnett: The communists.

04-00:06:32

Harberger: —communists, yeah.

04-00:06:34

Burnett: Yeah, or the Leftists.

04-00:06:34

Harberger: The Chilean strong Leftists. I forget now exactly what the precipitating factor was. But I believe it was a paper possibly by De Castro, possibly not, having to do with freer trade. Catholic University didn't want to publish it and there was a big revolt. Dean Chana had always been a great friend of our project. But I believe in this particular instance he was under pressure from the Vekemans group and maybe from a higher Catholic hierarchy over the Vekemans group and they didn't want to publish it. As far as I know, the entire full-time economics faculty threatened to resign and the end result of that was that De Castro became the dean and Chana left. And so we gained a certain sense of victory out of this great confrontation. And that almost guaranteed the further future of our project and the fruition of our efforts.

I wanted to mention at this time a somewhat different thing because this is not too directly related to our program but somewhat. Carlos Massad was the first of the participants in our program who came from the University of Chile and he went on to have a super distinguished career in government and in academia. And in the early Frei government, he was president of the Central Bank and the team was Sergio Molina and himself and a fellow named Edgardo Boenninger as budget director.

I was sent to Chile on a team from USAID, whose object was to formulate a long-run assistance strategy for Chile called LAS. I was the chief economist of that mission and in the process of preparing I tried to develop a diagnosis of the major macro-economic problems of Chile. What was happening was that had a significant rate of inflation. It was over 40 percent the year before. And they had interest rates that were capped at something like 18 or 20 percent, which means they were super negative in real terms. Very stupid kind of situation. And they had an exchange rate which was not keeping pace with the inflation, which they were trying to keep fixed, and thus was seriously deteriorating in real terms. Everything was a big mess.

We had talked about these kinds of problems in Chicago already and to me it wasn't a big deal to figure out what was called for. This was to recognize that

you're having a budget deficit that was feeding this inflation and that you were not living with the inflation very well. So what you wanted to do was to try to plan what was going to happen next year. We're going to try to have this budget deficit, the financing of which will involve so much inflation. When you have so much inflation you need an interest rate that is higher than the rate of inflation in order for it to be positive in real terms. You need an exchange rate that moves more or less with the rate of inflation. Not necessarily exactly because the real exchange rate should change with real circumstances.

So anyway, I developed this framework and I took it to the first meeting with Massad and Molina and Boenninger and they brought out their piece of paper. The two were virtually the same. They had come to an identical diagnosis. I always felt that this was a wonderful example of foreign aid at its best. That we were offering foreign aid to help them through a transition in which they would be lowering the rate of inflation and doing this in a sensible economic fashion without screwing up the interest rate story, without screwing up the exchange rate story. And they bought into it. The foreign aid was useful for what? To help them to sell this sensible project to the rest of the government. We had a package of money there as bait, so to speak. And everything worked for three years. The rate of inflation started over 40 percent and at the end of the third year it was under twenty. And real growth was going on at 5 percent per year during this process of disinflation. We were all ecstatic with that.

But at that point in time the left wing of the Christian Democratic Party, let's say the wing that was supported by Roger Vekemans, got into a position of greater influence in the Christian Democratic Party and they had agrarian reform projects and housing reform projects and this kind of thing and other populist measures. The inflation took off again and kept going up, as I remember, all the way up to 1970, which was the year of the Allende election. And things were not too great at that time, even though the '64 to '67 period had been excellent. And I want to emphasize here that Carlos Massad was a product of our project, so that this success was not unrelated to our project.

04-00:14:58

Burnett:

Juan Gabriel Valdes has written a book called *Pinochet's Economists* and it talks about the efforts of the Chicago-trained Chilean economists. They tried to influence the Alessandri government. Or the Alessandri government was working with them in 1958 but there was a rapid pullback from that. And so the—

04-00:15:43

Harberger:

Of that Alessandri government, that was the one where Fuenzalida was the one-man planning office.

04-00:15:52

Burnett:

Okay, I see.

- 04-00:15:53
Harberger: And there was, as far as I know, no other connection of importance between the Chicago products and the Alessandri government.
- 04-00:16:05
Burnett: According to this story, there was growing hostility within the university to the economics faculty.
- 04-00:16:18
Harberger: That is the Roger Vekemans incursion. Yes.
- 04-00:16:22
Burnett: Yeah. I think the university, in considering its Catholic identity, they were thinking that there needed to be social values and they wanted diversity of opinion in the economics department. And there were some efforts to accommodate that. I think they hired some folks who were more of a Prebisch-style economics approach. But at any rate, there was a growing discontent, as it were, up to say '64. And there were student protests, too, and that was in part stimulated by Vekemans?
- 04-00:17:11
Harberger: I have no recollection of that. The rival center in sociology, headed by Vekemans, was clearly the elephant in the room, so to speak, as far as this challenge was concerned. As far as I could see, it was the main and maybe only true source of difficulty.
- 04-00:17:46
Burnett: Right, right. And so there was a period of consultation. This is not necessarily to do with the Chile Project at all, but you were consulting for the Central Bank of Chile between '65 and '70. Was there a connection there?
- 04-00:18:06
Harberger: No, there was no particular connection there. I'm trying to remember where the financing came from. I'm quite certain that my connection with the Central Bank was linked to the LAS story. That following upon the LAS I would go, financed by not the Chile Project but by AID Washington, to help implement this scheme that we had devised at the beginning of the Frei administration. And in that role I was going to the Central Bank on these visits.
- 04-00:19:08
Burnett: And you wrote up some of your conclusions from that experience in a couple of places. I think you co-wrote something with Marcelo Selowsky, "Key Factors in Economic Growth in Chile: Analysis of the Sources of Past Growth and the Prospects for 1965."
- 04-00:19:28
Harberger: Yeah. I wouldn't link it to the LAS story. This was an analysis of economic growth in the Chilean context, using Chilean data. And that was nice. And I think I wrote something about the dynamics of inflation in Chile somewhere

around this time. That was another basically academic exploration. This is the kind of thing that we had had in mind at Chicago when the project started, that we would be using “economic science” to diagnose and understand the processes that were going on in Chile.

04-00:20:28

Burnett:

Yeah. And that was something that the students demanded or wanted out of the experience. They wanted to talk or learn about Chile. Some sort of complained that they were doing these general economic principles and they wanted stuff that’s more applicable to Chile. That was a story that I was reading again from this scenario. That doesn’t ring a bell to you, though?

04-00:20:56

Harberger:

Doesn’t really ring a bell, no. I mean, we were always talking about Chile in Chicago. So it wasn’t that we were in any sense going into the abstract side of things. In our project in Chile, what research was done was all done on Chile. And I mentioned we didn’t have Chicago first team people down in Chile. So I wouldn’t give a grade better than B for the studies that they produced. But they certainly were on the Chilean economy and were genuine in that sense.

04-00:21:53

Burnett:

When you described the Chilean economists in the program at Catholic University and their revolt against what was happening and their threatening to resign, it reminded me of [T.W.] Schultz’s move.

04-00:22:23

Harberger:

Exactly, exactly. It was very similar.

04-00:22:28

Burnett:

I know I’ve read one of Schultz’s reports on the Chile Project where he said something like, “We need to make sure these economists are protected from political pressure,” because he had that in his mind. That had been this event in his life. I can tell it had an impact on him. I don’t know what you can say to this but I have in my mind that that narrative was out there amongst the Chileans. Did they know that story?

04-00:23:04

Harberger:

I’m sure that they must have heard. Everybody must have heard the story of how Schultz got to Chicago. It may be that that helped strengthen their spines at this critical time but through knowing the personalities involved, and particularly De Castro, it came out of his genes also. [laughter]

04-00:23:39

Burnett:

Well, these are important figures. I don’t want to get off track too much. But could you talk a little bit about Sergio De Castro and a couple of these folks and what they were like and a bit about their careers.

04-00:24:01

Harberger:

Well, De Castro had great leadership qualities and he was capable of inspiring people and getting them to do things, pushing them beyond where most of us

would push, so to speak, and getting results out of it. So he was, without a doubt, the natural leader of the team. And he continued that when he came into government and was the leader of the Chilean economic team from '74 through '82. Without a doubt he was the central figure as minister of finance. And then there was Ernesto Fontaine, who was the supreme applied academic of the group. He wrote probably the best-selling text on price theory in Latin America over this period. Then he wrote the best-selling book on project evaluation in all of Latin America over this period. And then he organized a course in project evaluation outside the general curriculum but which fed into the government's project evaluation story. But all of this is now into the Pinochet period that that happened. And during the Allende years Rolf Luders and he and Nicolas Ardito Barletta were in Washington at the OAS. Nicolas Ardito Barletta was a Panamanian who had been head of planning in Panama. That office was was a sub-directorate and then it became a directorate and then it became a ministry. And Ardito was subdirector, director, and minister in that order. And in the end he, in 1977, was named Vice-President of the World Bank for Latin America and moved up to that.

But in this early period when Allende was governing in Chile, Ardito was working for the Pan-American Union, the Organization of American States. And he hired Rolf Luders and Ernesto Fontaine there. Rolf was his immediate deputy and Ernesto, under Rolf, was in charge of project evaluation for the whole hemisphere. He sent teams to most of the countries in the hemisphere trying to implement good project evaluation procedures everywhere with, guess what, mixed success. But in the process he was hiring as consultants many of the Chicago products who were in Chile suffering economic distress under the Allende government. And they were able to supplement their income with the consulting fees from the Pan-American Union and Ernesto's program. So this was a major operation.

Of course, this spread Ernesto's name and fame throughout Latin America and that carried on for his entire lifetime. He was always going to Uruguay, going to Mexico, going to Peru, Argentina when they were trying to implement project evaluation systems that looked something like the beautiful one that had emerged in Chile. I was involved in several of those missionary operations along with Ernesto. So we had a lot of good times together on that.

04-00:30:00
Burnett:

In the *Journal of Political Economy*, I think first published in 1966, you wrote a piece called "Economic Policy Problems in Latin America" and some of these apply to Chile and others perhaps not. But it gives a portrait of your kind of diagnoses of what was going on at the time: import restrictions that make exporting more difficult; the national markets were too small to affect the kind of policies that they were putting in place in Latin America; the agricultural sector, price controls, and the stimulation of artificially cheap imports by those means. What's interesting is that you were not necessarily against land reform if it was mixed with policies designed to increase productivity of the

land. Could you talk a little bit about land reform? Those are often considered to be poles in the history of international development. There were those who were for land reform and redistribution, consolidation of properties, and then there were those who were suggesting increased inputs in technology. And they're not necessarily mutually exclusive, right?

04-00:31:34

Harberger:

I am not known for being an ideologue in economics. I think I am a professional rather than an ideologue. And on issues of social policy I always believe that we deserve a seat at the table, or two seats, or three seats at the table but we don't deserve to be dictators at that table. And we have to listen to the pressures and desires of others than ourselves and try to bring good economics to whatever swing is happening in the political and social scenes.

Well, on land reform I always thought of the homestead program in the United States. If you talk about land reform, we were giving away 160 acres, I think it was, to whoever wanted it. And the idea that another country was going to try to improve its agriculture by means of some sort of land reform didn't bother me. I certainly never thought of land reform as confiscation and robbing of people. I thought owners should be reasonably compensated for whatever was taken from them. So I wasn't in any sense proposing land reform but I was thinking that if people are going to have land reform they should try to have something that was sensible, that was just, that was good economics, so to speak, or at least didn't fly in the face of good economics, which oftentimes it did.

04-00:33:51

Burnett:

Right, right. The clear, greater emphasis on technical training and agriculture. And something interesting, too. There was mention of teaching the public how to think in real terms. And by real you mean thinking of money in adjusted—

04-00:34:21

Harberger:

Adjusting for inflation in your head.

04-00:34:21

Burnett:

Adjusting for inflation, yeah. Is there economics extension? If there's agricultural extension where you're teaching farmers how to make improvements, is there economics extension for the public? Mostly for government, right? You're thinking about government officials?

04-00:34:43

Harberger:

This is what I may have said before. I think one of the great positive effects of our bringing people from the University of Chile, as well as Catholic University, was that good economics in my sense was being taught in both universities for a long period of time so that all of the intellectual elites that grew up, whether they became politicians and congressmen, whether they became newspaper people, television people, they all had this background in sensible economic policy in which they were taught what was the experience

of Chile under bad policies and how bad policies could be or had been corrected and how Chile was chugging along in most of the later period with much better policy. And public opinion was not averse to that.

04-00:35:58

Burnett:

And one of the other things that you mentioned in this article was a lament the poor data collection by ministries of labor, for example. So were there efforts to rationalize data collection? Was that part of it? Was that a small piece of what was happening?

04-00:36:17

Harberger:

Hard to find an empirically oriented economist who doesn't always want better data. [laughter]

04-00:36:32

Burnett:

[laughter] Fair enough. Fair enough. So there was some influence during the Frei government. Did you know Eduardo Frei?

04-00:37:05

Harberger:

I became good friends with Eduardo Frei but most of it was after he had left the presidency. I used to visit him in the Allende period. I made a point of visiting him basically every time I went to Chile. And the DINA, which was the intelligence agency of Pinochet government, they were watching all the time because he was at that point in opposition. But I went to see him at his office downtown most of the time. But a couple of times he invited Anita and me to his home for dinner. And then we had him visit Chicago at one point. I organized that visit and we had this big house with a big barroom in the basement where we had a party with Frei and company. And I have this great memory of Eduardo Frei, ex-president, dancing the cueca in our barroom downstairs. [laughter] That was a wonderful experience. I went to see him all the time until he died.

04-00:38:51

Burnett:

In the Valdes book there's a story about the deputy director of ODEPLAN, which was the state planning agency of Chile.

04-00:39:12

Harberger:

Yeah, yeah. Deputy director probably Miguel Kast?

04-00:39:15

Burnett:

It was Eduardo Garcia. In 1970 he was allegedly angry that Arnold Harberger and Jorge Cauas had allegedly written a scathing report for the Ford Foundation of a proposed project between ODEPLAN and Ford under the direction of MIT.

04-00:00:23

Harberger:

Well, that's what I talked about yesterday. It's exactly what we talked about yesterday. That this was a scathing report on that project.

04-00:39:51

Burnett: *That's* the project?

04-00:39:53

Harberger: That's the project. Yeah. It was not a project. When we got into the act we were reviewing what they had done in the previous years. We were telling them, "Look, you're missing the point. You're being super-academic where you should be diagnostic of what's wrong."

04-00:40:27

Burnett: So the piece of the story that's interesting is that as part of a reaction against the Chicago Boys at the Catholic University, coincident with the election of Allende, Garcia was appointed director of the economics program there, and then that precipitated an exodus.

04-00:40:55

Harberger: I don't have a clear memory of that. It may be that I subliminally blocked it out.

04-00:41:10

Burnett: And so the rest of the story in that book, *Pinochet's Economists*, from that time forward is about these associations of entrepreneurs in Chile, some of whom support the Chile economists when they are under the gun, as it were, from the university forces and from students and so on. And so one of the big figures—I guess this is prior to Allende—Agustin Edwards.

04-00:41:54

Harberger: Agustin Edwards, yes.

04-00:41:55

Burnett: Agustin. Okay.

04-00:42:00

Harberger: The family, the Edwardses, owned the *Mercurio*, which is like the *New York Times* of Chile.

04-00:42:11

Burnett: Okay. And they attempted to mobilize support in the business community and consolidate support around the good economics of Chicago.

04-00:42:28

Harberger: I believe that.

04-00:42:29

Burnett: Okay. There's just fairly limited evidence that Valdes is drawing from. I think Edwards leaves, actually, during the Allende administration. He tried apparently, allegedly, to get the Nixon administration to intervene in Chile and when that request was declined he took a job in Pepsi and retired to Connecticut or something like that.

04-00:43:15

Harberger: This is Duni Edwards?

04-00:43:15

Burnett: Yeah.

04-00:43:16

Harberger: I didn't know that.

04-00:43:18

Burnett: Yeah. And so can you put us back into that time? You were visiting sporadically. You were there in '64.

04-00:43:31

Harberger: Are we talking about the onset of Allende government?

04-00:43:33

Burnett: The onset of Allende.

04-00:43:34

Harberger: Well, let me go back then to that because this is an interesting story. I mentioned how the Christian Democratic government under Frei swung left in the last three years. And he had won the presidency in '64 and he had made a deal with Radomiro Tomic. He, Frei, would be the candidate in '64 and Tomic would be the candidate in '70 when Frei was not allowed by the law to succeed himself. And many of us lament the fact that he stood by that agreement. There were other candidates more centrist in the Christian Democratic Party who would probably have won the election outright and without a problem. But Tomic was a pretty far left member of the Christian Democrats. And what happened was that in the beginning of the campaign, the right wing was worried about Allende and tentatively decided not to have a candidate and to go with the Christian Democrats. But when Tomic revealed how far left he was those guys panicked and they pressed Alessandri, who had been president before but could not succeed himself immediately but could return, to become a candidate. Well, at that point there was a kind of a scrambling effort to get his platform together and in the process of that a group was formed under the direction of Emilio Sanfuentes and some other guy whose name eludes me, who was not from Chicago. Emilio was from Chicago. And there was this small team created which included Javier Fuenzalida, the brother of Luis Arturo. Included, I believe, Pablo Baraona. Included definitely Sergio De Castro. And I was intermittently an advisor to this group as they concocted an economic plan, so to speak, or an economic platform for Alessandri. Well, they presented this thing to Alessandri and company and the politicians found about 90 percent of it too radical for their tastes. So very little of this plan was manifested in the actual campaign of Alessandri.

So Allende gets elected and these guys continue to meet every week. I think it was Tuesday lunch or something like that. And they would be following the

economy. They had written these several chapters on different aspects of economic policy and they would be following the economy and saying, “What can we do to straighten out this? What can we do to straighten out that?” And the chapters kept evolving, so to speak, to be relevant for the current state of economic policy in that area in Chile. So when the military coup came, these guys were the only people in Chile who had any inkling of a plan, to speak, to deal with the economic turmoil that existed.

This is probably the best time for me to try to give you an idea of how bad it was in Chile. They had price control on about 3,000 items. But could you buy something at the control price? Only very rarely. In most cases people were forced to go to the black market, where black market premiums were not 10 percent higher, 50 percent higher. No, three times, four times, seven times the official price. When I went to visit Chile in March of '73 there were, I believe, thirteen official exchange rates to the dollar. The lowest of them was twenty-five escudos and the highest of them was 1,325 escudos. And the black market was around 2,500 escudos. Now, you have to think that grains of wheat are different from one to another. There are also many varieties of wheat. So wheat is not a homogenous thing. The US dollar is the most goddamn homogenous thing you can find in the world, so to speak, and here they had these prices ranging all the way. What an invitation to corruption! If you could get a dollar at twenty-five, you could sell it on the black market at 2,500. Why would anybody who got the dollar at twenty-five use it for anything except to sell in the black market? Everything was just wild. And the black market prices were so high.

04-00:50:22

Burnett:

So there were thirteen different exchange rates. How does that happen?

04-00:50:26

Harberger:

If you were going to buy, let's say, academic materials. Twenty-five escudos because they wanted to subsidize the academic, you see.

04-00:50:44

Burnett:

Okay, I see.

04-00:50:45

Harberger:

If you were going to buy inputs into such and such an industry, well, you could buy that at a hundred because they like that industry. If you were in a different industry, and you're buying materials, you had to pay 1,325. That kind of thing.

04-00:51:05

Burnett:

So instead of price supports you have different exchange rates depending—

04-00:51:14

Harberger:

Well, they had price controls but the price controls had little effect on the whole. The scuttlebutt was that if you were a party insider you could find ways to get items at the control price. But most ordinary citizens and most

products, they had to go to the black market for them. That was the story. And there were crazy situations. Anita had a favorite cabdriver that she sort of arranged to drive her around when we were in Chile. And he reported being paid a chicken for a taxi ride. [laughter]

04-00:52:05

Burnett:

So it's barter. We're now in a barter economy.

04-00:52:07

Harberger:

It was just an utterly, utterly wild thing. To give you an idea of what you could do. The biggest hotel was the Sheraton San Cristobal, which was up on a hill, and a very elegant hotel. You could get a suite in that for two dollars a night. If you bought your escudos at a black market price you could pay two dollars a night for a suite. They had marraquetas, kind of a Kaiser roll type thing, type of bread. You could get like a hundred of them for a dollar. I remember they had tokens for telephone calls. You could get 500 tokens for a dollar sold in the black market.

04-00:53:10

Burnett:

And on the other side, the Chileans are selling at fire-sale prices things that they own just to get dollars to be able to use.

04-00:53:18

Harberger:

Well, and the interesting thing. By the time it ended people would be going over the mountain to Mendoza to buy scarce items, and like cooking oil for the kitchen and soap and things like that. But things like relics, works of art, etc. were so cheap in Chile, if you bought in the open market, as it were. It got to the point where the official inspections of your baggage were on exit rather than on entry. They didn't want the riches of Chile to be siphoned off at these, in effect, bargain prices that you could get because everybody wanted a dollar. So it was a totally unhappy situation. Unemployment was going up and companies were in terrible trouble. Nearly all of manufacturing was either nationalized or intervened. They have a concept in Latin law of intervention, which is a little bit like the receiver in bankruptcy. So you're still the owner but the government person is running the show. And these guys would be making losses at the control price and they would raise wages because they were in favor of the workers and all these operations were having losses. It was just an awful mess. And there were big demonstrations in the street, women banging pots and pans and so on. And it's hard to find anybody who will try to say that economic policy of Chile in 1973 made any sense whatsoever. It was basically a kind of chaos.

And it was in those circumstances that the military coup took place. And we believe that the military coup was supported by a majority of Chileans when it happened. The Christian Democrats, at least the Frei Christian Democrats, favored the coup. Frei was an ally of the military government for the first year or so. Paul Rodan and Raul Saez had been members of the committee of nine

of the Pan-American Union, of the OAS under the Kennedy program of—what was it called—Alliance for Progress.

04-00:57:05

Burnett: Progress, yeah.

04-00:57:06

Harberger: The Alliance for Progress. Both of them had offices in the Diego Portales building, which was the center of government right after the coup of the military government. They had offices in there for that whole first year. Only later when Frei broke, withdrew his support, so to speak, from the military government, only then did Rosenstein-Rodan and Saez depart from those offices. But anyway, this is just to give you an idea that there was lots of support for the coup when it happened. And the reason for the break of the Christian Democrats with the government was not connected, as far as I can see, with the issues of repression. It was connected with the fact that during the year in which they were supporting the government, they expected to be given the keys and become the main force in government. And when it became clear that they weren't going to be given the keys was when they moved to opposition. So it's an interesting kind of story.

So anyway, these guys who were revising their chapters had the only coherent vision of how to handle a reform of economic policy. They became undersecretaries and vice president of the Central Bank, with the military being ministers and president of the Central Bank. All but one of the ministers originally was a military person. Fernando Léniz was the only civilian minister at first. Anyway, they made a lot of reforms, including getting rid of all but five or six of the price controls rather quickly, unifying the exchange rate and having it flexible in the market, reforming the tax system, introducing a value added tax, which was badly needed in place of about 200 very specific crazy taxes. It was absurd. You would get a restaurant bill and here would be the total and then it would say, "Law number 105, you owe 2.5 percent. Law number such and such, you owe another 1.8 percent, et cetera, et cetera—" [laughter] There would be six or seven—

04-01:00:40

Burnett: Special assessments, right.

04-01:00:40

Harberger: —separate taxes that were separately categorized in your bill. And they got rid of those and united them into a sensible and well-founded value-added tax. They had income tax with rather high marginal rates. I think the marginal rate went up to 60 percent at that point. I think it's still now 40 percent in Chile.

Anyway, they had made a lot of reforms in different areas of the economy. Where they failed was in the control of inflation. And I think you may have heard me talk about this in other place but these *interventores* who were running many of the private companies, I call them the commissars. And

during the Allende period these commissars were running losses and how did they cover those losses? Well, they borrowed money. Where did they borrow money from? Well, it went to the commissar who was running a bank, who had been to a Moscow school with them, and they said, "Lend me money." And the guy would lend them money and that's how the system kept going with great inflationary force.

So with the coup these commissars were all sent away and they were replaced by colonels. Well, what happened was that actually the Junta gave an order to these colonels that you were not allowed to have losses. [laughter] Well, there was no way they were going to avoid the losses under the circumstances, so they had the losses. So what did the colonel do? The colonel went to this other colonel who was running a bank who had been to military school with him and they borrowed the same way. So it was the same old system, it was just colonels replacing commissars. That ended in a 20 percent per month inflation.

04-01:03:34

Burnett:

Wow.

04-01:03:35

Harberger:

And that was about the same rate of inflation that was going on in the latter part of the Allende period, it just didn't go down. And that was when [Milton] Friedman and [Carlos] Langoni and I paid that famous visit to Chile in March of '75 and made a variety of speeches. With Friedman, we met with Pinochet and Friedman gave his diagnosis to Pinochet of the economy, which I must emphasize contained nothing that the economic team had not advised already. It was not that there was anything unique about Friedman's advice; it was just good solid economics of how to bring this inflation under control. And it was two months after that that the military withdrew from cabinet posts, or at least most of them, and they were replaced by the Chicago Boys and other civilian people. What was implemented then was a quite important fiscal shock to get rid of the deficit, but zero monetary crunch. The rate of inflation was brought down only gradually from 400 percent to 300 percent to 200 percent to 100 percent to 60 percent. So it was getting down to 30 percent around '78 or nine and got down to in the neighborhood of 10 percent around '81. So it was a very gradual disinflation. No attempt at shock treatment in that area. So the fiscal adjustment was one factor that contributed to 1975 being a significant recession year but it wasn't the only factor. There was a world recession at that same time, and most importantly, there was a tremendous drop in the price of copper. So those three factors, the fiscal crunch, the world recession, and the drop in the price of copper combined to produce that 1975 recession. But following that there was growth at about six percent per year going all the way up to '81. That was the big recovery period for the Chilean economy. Everybody was quite enthusiastic about the way things were going. But there were some hidden troubles.

What we are next talking about is the debt crisis of 1981, '82. And that is something that was not Chilean, so to speak. Mexico suffered from a debt crisis. Argentina suffered, Peru suffered, Uruguay suffered, et cetera. The Philippines suffered. What was the overarching cause of this debt crisis was the oil price boom of 1979. What had happened was that oil prices went way up. And if you were an oil country with a lot of population, in general when such countries get more money and they want to spend it. But if you're Saudi Arabia, Oman, Qatar, those Gulf state countries, they didn't have populist pressures working on them and so they put the proceeds of this big oil price boom in the international banks. Barclay's Bank and Chase Manhattan I think it was at that time and Citibank and so on. And then these banks had tons of money and they had to pay interest on this and they had to earn interest in order to pay interest. They discovered Latin America and they sent their representatives down with bags of money, as it were. We had a joke among ourselves. One couldn't find a room in a first class hotel because all these world bankers were there trying to shove money down the throats of the Latin American countries. It wasn't quite that bad but there certainly was pressure from these banks. They were offering. They weren't sitting back and waiting for applications and minutiously studying these applications and rejecting half of them or anything. No, they just had to get rid of this money.

So then the oil price boom collapsed and this flow of money stopped. It didn't reverse particularly but it just stopped and as a consequence the abundance of dollars turned into a relative scarcity of dollars. The price of the dollar went up and a whole set of adjustments were forced upon these countries, which precipitated the recessions that they all shared. But in each case there were internal stories that were revealing different weaknesses in the respective economies and these internal stories had to do with the timing of when the debt crisis would hit, so to speak. In Chile there was a sugar company named CRAV, C-R-A-V, La Compañía Refinera de Azúcar de Viña del Mar. And it went bust having wrongly speculated in the futures market for sugar. And when this bankruptcy took place, in the bankruptcy proceedings it was found that, first of all, they owed money to practically every important bank in Chile, not unusual for a very big company, but that about half of these loans were unsecured. And the international banking community was scandalized by the fact that these Chilean banks weren't asking for collateral when they made these loans. Well, I know how it works. The head of CRAV at that time was a very distinguished member of an ancient Chilean family, Don Jorge Ross.

04-01:13:03

Burnett:

Don Jorge Ross?

04-01:13:04

Harberger:

Ross. And my imagination has Don Jorge being here, you're the president of the bank and I am Don Jorge, and I say, "Well, of course you're going to want collateral on this loan." And you respond, "Oh, Don Jorge, not

from you.” And I’ve told this story to many Chileans and they all nod their heads in agreement, that this was the Chilean way at that time.

04-01:13:48

Burnett: Different rules for the elite.

04-01:13:50

Harberger: Well, these very respected people certainly got treated specially. And so that was part of the precipitating element in the Chilean debt crisis. The banks, the international banks, were less ready to keep flows coming to Chile once they had learned that. That was one part of the story.

But another part of the story was the wage rises. Chile at that point had been on a fixed exchange rate. The exchange rate had been fixed at thirty-nine pesos to the dollar in June of 1979. And as I mentioned yesterday, in good times it sings like a bird and it was doing fine in the interim. But as this crisis loomed on the horizon, obviously if you have a fixed exchange rate and the dollar is becoming scarcer, the dollar is supposed to become more expensive. How does the dollar become more expensive when you have a fixed exchange rate? It’s by internal prices and wages going down. Well, in the background of this there was a labor law which had been put into effect a couple of years before the help of Pepe Pinera, who was labor minister at that time. And there was pressure from American unions about the treatment of labor in Chile, and in part responding to that pressure Pepe had put into this law a clause that said, well, companies would negotiate wages with the union and so on. They didn’t have industry-wide unions, they had company-wide unions. So they would negotiate a wage and this would be holding for a certain period of time, but then there would be a new contract. And the clause that Pepe inserted was that at a minimum the new contract had to provide for an increase equal to the price level rise from the last contract. If there had been intervening rises then it only had to make up the difference. But if there had been no rise it had to fully compensate for the intervening price level increase. Well, at the time when this labor law was created, everybody was optimistic. Chile was undergoing 6 percent per year growth and so on and the idea that real wages would remain constant didn’t seem like anything. But here this clause was causing a 15 percent rise in real wages on average in August of 1981, when they would have been far better off with nothing and even better off if it had been a 15 percent fall in real wages.

04-01:17:46

Burnett: Because of its inflationary effect.

04-01:17:48

Harberger: So in any case, this labor law situation created an exacerbating factor in the debt crisis. Whereas the needed adjustment was a reduction in real wages, the labor law thing created an increase. Well, end result of all of these factors, with the fixed exchange rate at that time was unemployment, and this was the elephant in the room.

04-01:18:28

Burnett: The incontinent elephant, yes.

04-01:18:30

Harberger:

Yeah. From June of '81 to June of '82, unemployment went from about 8 percent to over 25 percent. It was just shocking how terrible it was. The thing was further exacerbated by the fact that somewhere around September Pinochet had got on the television and said, "For this country it would be suicide to devalue," at which point no minister dared suggest a devaluation. And it just went on and on. So that ended in June of 1982 in a comic opera experience. I was in Chile at that time and I was in a bar in the evening. The bar had a television set. And all of a sudden the program was interrupted or something and anyway, who came on but General Danús. General Danús was minister of economy and he was going to make an announcement. This was a Friday night. And he said, "Starting Monday, instead of the exchange rate being thirty-nine per dollar, it is going to be—" I think it was forty-five but I'm not sure. I don't remember precisely. It was going to be, say, 45. He said, "Now, citizens of Chile, I want you all to recognize that this is in no way a devaluation." [laughter] This is in no way a devaluation. This is merely a correction of a mistake that we made." That when in June of '79 we fixed the exchange rate to a dollar, we should have really fixed it to a basket of currencies representing our relations with the whole world economy, not just the American economy. And if we had done that, fixed to such a basket in '79, then today the rate for the dollar would have been forty-five or forty-six, whatever it was. Well, it turned out that that forty-five or forty-six lasted about five or six weeks and it was up to fifty-one or fifty-two and the whole thing began to splay out. My guess, that they were not finally back to real exchange-rate equilibrium until that rate got to something like 200, after a few years..

04-01:21:48

Burnett:

The whole time you've been telling this story I've been staring at my notes of your prescriptions for dealing with inflation in 1966, *Economic Policy Problems of Latin America*: Allow for more frequent adjustment of interest rates and even of real wages. So there you are. And obviously teaching the public how to think in real terms. That didn't necessarily happen. So this is your experience in the moments you've been in Chile experiencing some of these things at these key moments. But speaking of the political pressure on the Chicago Boys in the 1960s and the pressure on Schultz when he was at Iowa State, were there any repercussions or allegations in the press for you and Milton Friedman because of that visit? That's sort of known, right? Students were protesting at the University of Chicago. Is that right?

04-01:23:14

Harberger:

Well, that came much later. The reaction to Milton's visit went on for more than a decade. And practically everywhere he went there would be a demonstration. The most dramatic was, of course, the demonstration at the Nobel Prize ceremony itself in Stockholm. So he suffered quite a lot. And the

amazing thing about Milton is he showed no animosity to Rolf Lüders and myself for having invited him, so to speak, to come to Chile on that occasion. And he showed no regrets for anything he said while in Chile. And, indeed, he had stated while in Chile his belief in free representative government and had stated his faith that a free economy will lead in the end to a freer polity. And in the case of Chile that actually happened. I don't believe that that is a law written in stone by any means. But he did and he was right on this critical occasion. So I had maybe half a dozen or more demonstrations against me in the same vein as his but mine were far fewer in number and probably lower in intensity. In all cases, both he and I would offer to meet with people and to just sit down and talk about it and answer questions and state our case, so to speak. And that is something that we definitely did. In such circumstances there are usually people in the audience who are persuadable by statements of the fact that at least we didn't have horns and we didn't have any motivation to collaborate with this government which was doing all these horrible things. The fact was that most of the horrible things took place during the earliest period of the first year, even the first three months. The coup itself first and then the assembling of people in the stadium and so on. I kept track of the disappearances in Chile and they were ever declining numbers and reached zero somewhere around '78. Meanwhile, I withheld any collaboration by me with the Chilean government for something like five years until those disappearances were zero.

04-01:27:34

Burnett:

And you did engage in the press because there was a piece, I think, in the *Economic and Political Weekly* by Andre Gunder Frank. He was a student of Milton Friedman's?

04-01:27:49

Harberger:

Oh, he was a student of all of us.

04-01:27:51

Burnett:

He took classes with you?

04-01:27:54

Harberger:

Not only did he take classes with me, but I invited him to join my workshop. And we were part of a sort of a general social group. My colleague George Tolley was there, one of them. I can remember going for drinks to Andre Gunder Frank's house and him coming to my apartment, my coach-house apartment and having drinks. And I invited him to be a member of my workshop. I knew that he was left-wing and it didn't bother me at all. But he wanted to do his research on such a topic, so to speak, on a sociopolitical topic which was not in the spirit of my workshop at all. And in the end I said, "Well, you can do what you want but you're not going to be financed by me." How much of the animosity that he later showed to me would have been influenced by that event I don't know. But it's no doubt that his left-wing politics by itself could have led to many of the things that he railed against. But anyway, that's the story about Andre Gunder Frank.

04-01:29:51

Burnett:

Okay. Yeah. And just to illustrate the ire, he called the Pinochet regime a practice of economic genocide, the prescriptions of the Chicago Boys in that case economic genocide. So that gives you a sense of the tenor of the times. And so you took to the *Wall Street Journal* and wrote a piece setting the record straight.

04-01:30:24

Harberger:

Yeah, that was at the time of Milton Friedman's receiving the Nobel Prize. I wanted to make sure that somewhere in public view was an accurate statement of our view of what was involved there and what were our attitudes there. And I guess you've read that.

04-01:30:58

Burnett:

Yes. And you stated, "We refused to consult for the Chilean government," and made no apologies for the extension work that was done. This was good solid economic advice as far as you were concerned. You wrote rather poignantly, I think, about the personal toll on your students. That it wasn't this uniform group of economists who then went to work for the Junta directly. One had left, one was in exile, others were staying away from Chile. Friendships were broken up. These are disagreements. These were people that you knew and cared about. So there's a personal side to the story for you.

04-01:31:50

Harberger:

I'd say the principal point was that we respected the decisions of all these people – both those who withheld their services and those who offered their services. We believed that both of these decisions came on an honorable basis, to so speak. That the ones who were working with the government were trying to help the Chilean people and the ones that were staying away were trying to protest against the military government. So there you were.

04-01:32:49

Burnett:

Yeah. And so of course in the reflections of historians who've meditated on this period and numerous commentators, there is this repeated contrast between the forces promoting democracy, social justice, and then these hyper-rational Chicago economists coming in. And you made a comment, I think in 1980, there's a *New York Times* piece by Ann Crittenden, February 7, 1980, and you were asked to comment about what took place. And you said, "Those who do best in the policy game are those who know how to make those tools," and you list your toolkit of policy advocacy, "how to make those tools work. People who criticize this attitude for an alleged neglect of non-economic considerations usually have in mind such things as morality, democracy, and justice. But to me non-economic considerations are when presidents trying to get reelected announce special projects for Florida." Because there is this question in history, of American history in particular, about this relationship between science and democracy, between this effort to govern well and this effort to govern right. And there is this preoccupation with this distinction between facts and values. Can you talk about that set of questions? When

people are asking you, “But, Dr. Harberger, you need to do the right thing for X.”

04-01:35:01

Harberger:

I am going to mention maybe three US presidents. In some ways the most clearly admirable was George Herbert Walker Bush. Was brought up to not crow about himself, did a wonderful thing when the Berlin Wall fell. He didn't want to gloat over the victory and thus ruin things for Gorbachev. He realized what contribution Gorbachev had made and so on. He was a gentleman all the way and in his bones, so to speak. Now, at the opposite extreme you have Nixon, who had few of these virtues. But I think that in foreign policy Nixon gets very high marks. And the opening to China is a major shift and one that would have been hard for anybody other than a distinct right-winger, so to speak, to be able to do. And in between you have Lyndon Johnson. If there ever was a conniver in the presidency, and somebody who would use any means to achieve an end, it was Lyndon Johnson. And yet from a standpoint of the advance of blacks and other oppressed minorities, he's probably the greatest president since Lincoln. So there you've got it. All of these things are there and people can be flawed in some ways, as Johnson was, and yet great in other ways, and the same thing with Nixon.

04-01:38:08

Burnett:

Even political actors acting out of venality or with perhaps the wrong intentions can accidentally produce results that are positive.

04-01:38:26

Harberger:

The world goes on in its own way and the results that we see come from forces that are good, that are evil, and that are many things in between. And they're all present. The thing rolls on. And at the end one has to try to learn lessons from history and at the same time realize that we are here, the future is there, and not to be overburdened by the past, as many Europeans are. Christians in the Balkans, for example, still think of Albanians and Kosovars as traitors.

04-01:40:45

Burnett:

Traitors?

04-01:40:46

Harberger:

Traitors. “When did this treason take place?” “Five hundred years ago.” When they converted to Islam under the Ottomans. Such a long time to stay an enemy! It is the same with the Shias and the Sunnis. How many years ago was that? It was six hundred or seven hundred and something AD that that breach took place.

04-01:41:13

Burnett:

In these examples that I'm hearing, these are almost inherited beliefs or customs or superstitions about other groups of people. It's a kind of tribalism. And then there's personal corruption. Those are kind of the negative aspects

of politics. And you've often written that the Chicago approach is—you talk about depoliticizing a situation. And that's what you're thinking about when you think of depoliticizing a situation. You're focusing on the real economic problems. And for you those economic problems should be as much as possible segregated from that world of values. Is that a fair criticism or assessment, analysis, of what you think?

04-00:42:13

Harberger:

No. Let's say you have the British state, the Scandinavian state of twenty, thirty years ago, which was more statist than the British state, more welfare state than the British state. You have America. You have maybe Singapore or Hong Kong. And I feel quite easy with all of these things. That these are choices that societies make about how they want to live together and so on. There's a lot of room for good economics in any place in that spectrum. So this represents a huge range of right to left politics. And I feel quite easy with helping the government or thinking of policies that would fit within a frame anywhere along that spectrum. Where I talk about depoliticizing something, it's our Congress today. These people are holding attitudes that are stupid. And what's the guy's name who insists on these pledges about never raising any tax? Grover Norquist. I think he is a noxious creature. There can be times when, if you have a bunch of expenditures, you have to meet them. You have to cut expenditures, yes. But the idea that all of the burden is going to be in cutting expenditures might not fit so well, and especially not when one has a tax burden which is not excessive and which we have had significantly higher in other times. And other countries have successfully had significantly higher many times. I think that where people are led to hide the lessons of good economics in order to keep the ear of certain elements, that can be a difficult choice and I can understand why somebody would really think taxes should be raised but not say it. Because if he said it they would never ask again for his advice. But I certainly admire Marty Feldstein, who was one Republican who came out for higher taxes when higher taxes were a reasonable thing. No bad economics were involved in him taking his stance, saying taxes should be raised. But he had to leave government as a consequence.

04-01:47:20

Burnett:

Coming back to Chile, there's this question or concern about demagoguery, right? You're selling people on something that sounds good in the short run. That's not Chile necessarily but it's many cases where that policy—

04-01:47:40

Harberger:

Well, populism in general. My shorthand definition of populism is “promising things you can't deliver.”

04-01:47:49

Burnett:

Yeah. And economics as a science, Chicago or not, is concerned with the relationship between the timing of things, right, and the consequences of actions in relation to other objects. And so economics has a lot to say about promising things you can't deliver. It has a lot to do with delivery dates and

the amount there is to be delivered. If there is a tension between when people talk about democracy versus a certain kind of economic rationality, that might be part of the story.

04-01:48:40

Harberger:

I certainly think that the mindset of the population at large is very important in determining where they go economically. It's to me still amazing how in Germany the shadow of the post-World War I hyperinflation still bears on German economic policy a century later or nearly a century later. It's incredible to me but it certainly is true. And I think on the whole Germany has benefited from that lesson having been learned. And other countries have fallen into trouble because of it. I think at the same time it is worrisome in the United States the degree to which individual responsibility for their actions and for their behavior in general—it used to be more important a value than it is today. And I think that the society loses from that. I think one of the most painful observations is the fraction of black children who were born and grew up in integral families having been so much higher in the 1950s and sixties compared with today. Now, with this flourishing of our society, why should that deterioration have taken place? Well, I think it's a tragedy. One lives with consequences even if one does not know what they came from.

04-01:52:00

Burnett:

Well, perhaps we should take a break.

04-01:52:00

Harberger:

Okay.

Session 4B, Afternoon

04-01:52:07

Burnett:

This is Paul Burnett talking with Dr. Arnold Harberger. This is the afternoon session of our fourth session, December 1, 2015. And we have been talking about the sequelae of the Chile project in the 1960s and seventies and some of the personal blowback that you got and that Milton Friedman got. And there was one more piece of it, that you got a request in 1980 to become head of Harvard's Institute for International Development.

04-01:52:51

Harberger:

Correct.

04-01:52:51

Burnett:

Can you talk about that?

04-01:52:53

Harberger:

Well, there arose a vacancy in the leadership of the Harvard Institute for International Development and I had worked with them on some projects and I had overlapped with many of them in other cases, where I would be going to Indonesia sponsored by AID. But HIID was there with Malcolm Gillis and so we would get together and schmooze. And in any case the economists in HIID

wanted me to be their next director. There came a series of preliminary negotiations and finally an offer from them to actually take that step. And in the meantime there arose within HIID, from the non-economists principally, a resistance all connected with the Chile operation. And this culminated in a big meeting in which Malcolm Gillis and I were speaking on our side and Steve Marglin and somebody else who was I think an anthropologist—

04-01:54:59

Burnett:

David Maybury-Lewis?

04-01:55:00

Harberger:

Maybe. I just don't remember the name. They were speaking on the other side. That was the kind of meeting where probably few minds were changed. But it didn't erupt in a riot or anything like that. It was a very sedate meeting. But in the end, as I mulled over that offer, I decided that what sense did it make for me to go to undertake the leadership of an organization in which my first two years would be spent trying to convince half of my staff that I didn't have horns? So it just did not make sense and I decided to stay at Chicago. We had a big dinner with the president of the university to celebrate that I was staying. And that was the end of that.

04-01:56:28

Burnett:

Right, right. But it speaks to some of the differences of opinion, shall we say. Or maybe it doesn't. Maybe it was just that there was a certain level of controversy surrounding the Chile Project and it made something bigger than it otherwise would have been?

04-01:56:53

Harberger:

Well, I don't know. Harvard itself had had HIID or its predecessor, DAS, in Pakistan through one military government after another after another. They were in Indonesia in the Suharto period. I don't know if you call that a military government or not. But in any case, they were there. They were in lots of places in Latin America and out of Latin America with authoritarian governments. And not only they but many economists. Anne Krueger went to Korea when they had a military government in Korea. She never had any problems. Why did everything sort of coalesce on Chile? It certainly was not true that Chile was the cruelest of these governments by any means. The scuttlebutt among us was that in Argentina they killed the opposition and in Chile they exiled them, which I think is a partial explanation, that there were Chilean leaders in exile in the United States and most especially throughout Europe. And the European socialists had come to love Allende, that somehow this was a victory for socialism within Latin America, and in spite of how terrible was his economic policy, he had that *éclat*, or whatever you want to call it, within Europe. The end result of it was that there was much more lamentation of the fall of Allende than there was connected with any other situation. But suppose this had been Chávez in Venezuela. If he were to fall no tears would be shed anywhere around. But Allende had this thing. And certainly Allende's fame did not at all come from the elegance of the

government that he ran and the policies that he adopted. It was something, just that he was a democratically elected socialist leader in Latin America or something. I think that fact, combined with the exile story, is probably the best explanation of why all this attention to us in Chile and no attention to anybody else in any other place, which is really kind of crazy.

04-02:01:04

Burnett:

I think some critics, like Gunder Frank, for example, linked the nature of the regime—and this is a claim that comes up more recently in *The Shock Doctrine* by Naomi Klein—this notion that this kind of economics flourishes in undemocratic spaces, right?

04-02:01:37

Harberger:

I have dealt with this so many times and it's so crazy. There is not a single major Chilean economic policy which in the broad was not imitated subsequently by at least five or six important Latin American governments, democratically elected governments. So what is the sense, that there is something in the nature of these policies? They were kept in Chile by four democratic presidents. So what is that sense? It cannot be. Now, the element of truth is that if Chile had had a freely elected democratic government in 1973-74, that government would not have been able to implement those policies *then*, because the ECLA aura was still floating around in Latin America and it was not something that you could get majority votes on *then*. But there is nothing intrinsic in the policy that is antagonistic to democratic governments. We've seen it all over the world, in a way. The whole world has gone in that direction as compared with where it was in the sixties and seventies, and to the great benefit of mankind. What can you say?

04-02:03:40

Burnett:

Well, I think we should have a session on the legacy, on that soon. Unless there's something you would like to add about Chile in the seventies or the sixties, for that matter, I'd like to move more into the project evaluation phase of your development work. And maybe a good place to start would be the Panama work, which is over a long period of time. It's very long.

04-02:04:16

Harberger:

The Panama story is an interesting story. The intro is that from sometime in the very early sixties up till 1977 when Nicolas Ardito Barletta went to be vice president of the World Bank, the head person in planning in Panama was a student of mine, one or another student of mine for all but twelve days. [laughter] Some president was removed after these twelve days and so it was during those twelve days—Arias, I think was president—that somebody different was in that slot. So anyway, the beginning came when I was called by the Pan-American Union, Organization of American States, and asked to help evaluate the five-year plan that Panama had submitted. Background of this was the Alliance for Progress in the Kennedy Administration had as a requirement that each aid recipient had to have a five-year plan. That sounds odd, doesn't it?

04-02:06:03

Burnett: Yes, it does.

04-02:06:04

Harberger: Could be six years. Four at least.

04-02:06:07

Burnett: Right.

04-02:06:11

Harberger: [laughter] But anyway, this was the first Panamanian five-year plan and they had this Committee of Nine, which were called the Nine Wise Men, of which Rosenstein-Rodan and Raúl Saez were two of the Nine Wise Men. And they would receive these plans and they would have to opine over these plans and only with their approval would the thing go forward with financing from AID. So each plan was reviewed by a committee of four people, of which two were chosen from the panel of nine—these were the true wise men. And then there were two fake wise men from the outside. One was Ernesto de la Guardia, who had been president of Panama earlier, and me. And so we met in Washington, the four of us, and they elected me to be in charge of the preparation of the report. And so I got Rolf Lüders, who was still a graduate student at Chicago, to come to Washington and to reside in Washington during the whole period of our study. And he ran the staff on this operation. And the plan had been prepared by Rodrigo Nuñez, who was a Chicago student who hadn't finished his PhD but had done well all along. What happened is they would pass a bunch of prelims but not get to the thesis stage. Actually that may have been a wise move in the sense that the value added of the thesis writing stage doesn't help much for policy makers. In any case, this plan had been practically handwritten by Rodrigo, who suffered from physical disability in terms of a cleft palate but was an ardent womanizer in spite of that. [laughter] And not excessively handsome either. He was a short guy and nothing special about him. But he had a way with women. In any case, he had written this plan. I sort of loved that plan. Panama only had a bit more than a million population at the time, so it was a really small country. And the plan had a series of investments, and one of these investments was to build a new jail. [laughter] National planning.

04-02:09:27

Burnett: One more new jail.

04-02:09:30

Harberger: I don't know exactly what it amounted to but there is this area, Punta de Paitilla, which is a promontory heading out into the bay in the Pacific side of Panama by Panama City. Today, that is the Fifth Avenue of Panama, all high-rise buildings, luxury apartments, great restaurants and all that kind of stuff. But Punta de Paitilla then was little more than a swamp and it had to be rehabilitated in order to permit this development. So one element of this plan was this crazy little thing, build another jail, and the other was do this operation which ended up being probably the most economically productive

expenditure of public money ever in Panama in terms of the value that it ended up permitting to be created.

Anyway, we issued our report on this five-year plan and everything went through. And guess what? From that moment on I was a virtually constant intermittent consultant. There was no year where I didn't go at least two or three times to Panama during that period. And I did many different things. I wrote a lot of things. They put together at one point a collection of some of the papers that I wrote. And I remember in particular something that few economists can say. That there was a period of about four or five years, at least, where I myself was responsible for the projections of public revenues and expenditures of Panama that were used in the planning exercise that they went through. And this meant making projections of all the tax receipts, of each tax, and the budgetary expenditures on each line of expenditure. And let me tell you that if you're conscientious and you're doing these things, nothing is more sobering, than to look back at what you had predicted or suggested for this year and then see what really happened and what were the consistencies and non-consistencies. And certainly there's a great learning process involved and it does instill a certain humility that you're not the genius that some might pretend to be.

04-02:13:10

Burnett:

Well, if part of your genius entails at the outset epistemological humility and a suspicion of planning, then I think you're well-positioned, aren't you? If your plans [turn out to be off the mark] it just confirms your original hypothesis.
[laughter]

04-02:13:33

Harberger:

[laughter] So anyway, I was doing that for that long period. It's a fact, I wouldn't want to say it's due to what Panama did in policy or what it did in planning or anything like that, but Panama was the leading economy of Latin America in at least the sixties. We begin in '62 and went through into the seventies. And Panama continued to have good growth in the 1970s also, but not as spectacular—Brazil was the big champion of the seventies.

Anyway, that was an experience of hands-on business and dealing with infighting of government and so on. I remember they had this great growth in the 1960s, and in the early seventies we were making projections for the seventies. We didn't want to project a continuation of the growth of the sixties but we got a reaction from the president's office saying, "What the hell are you doing projecting less growth now than there was in the sixties?" You can understand how they would react in that way. And we pushed and pressed and did an analysis of growth and said, "Where does this growth come from?" Obviously they will get to this. The real cost reduction, technological improvement, whatever you want to call it, is the most volatile component of growth rates and is always big in big successes and always small in big failures. And we said that they had had outstanding levels of real cost

reduction in the 1960s and we were projecting good levels but not A plus levels, so to speak, for the 1970s. And we were right. They were wrong. But I think we had 4 percent, they wanted 6 percent, and we ended up compromising on five.

04-02:16:18

Burnett:

I imagine one of the things that those leaders in all of those cases have to confront is the revolution of rising expectations, right? So that there's initial growth success with a great degree of borrowed money and so the public and the leaders themselves come to expect continuous growth rates. And perhaps—

04-02:16:54

Harberger:

And it's all wrong. The thing is that most of the time when there is high growth it has little to do with the economic policy. Most of the time when there is low growth it has little to do with economic policy. It has to do with what's happening to world prices of exports. It has to do with the weather and climate effects on agriculture and a lot of other things. And, of course, policy does matter. But if you think of the way policy really works in most cases, of which, let's say the Chilean episode was a notable drastic exception, but I use the term a patchwork quilt. That each government inherits this patchwork quilt where the patches are pieces of legislation that were placed in different presidencies or governments of the past. And when you get this, first of all, there are good parts and bad parts. But of the bad parts there are some that are immutable from a political point of view. You can't get to deal with them. So you have a limited segment of these things that you can deal with. Then you have limited resources with which to deal. So you probably have to select from among that limited segment. So you put your own patches and you make some improvements and you probably make some mistakes and make things worse in other respects and then it passes on to the next government. That's the way policy works. And when you think that in such a process somebody is saying, "We moved the growth rate from four to seven percent," what of these patches is responsible for that? I'd say as more than a general rule it is never true that a few patches are going to change the growth rate from four to seven percent. Never.

04-02:19:23

Burnett:

You mentioned that in the assessment of Latin American policy in the 1966 paper. You mentioned that on average, I think, less than 10 percent of the budget is available in these countries for discretionary purposes because it's claimed by all of these other categories. And George Shultz and Kenneth Dam write about that in *Economic Policy beyond the Headlines* in the case of the United States.

04-02:19:49

Harberger:

Right. Wonderful book. Yeah.

04-02:19:50

Burnett:

They're talking about in the mid-1970s, exactly at this time, where they sort of go line by line and George Shultz is in a position to know about how much is set aside and the ways in which there are shadow set-asides. So that's an important story. And I guess I'm also thinking that there's something about your style of engagement in international development work that is the opposite of your caricature of the instant expert. That you tend to develop these long relationships. You have one-off consulting. There's lots of examples, I'm sure, that we'll talk about later of one visit or whatever. But this is a case where you were involved with Panama from '62 to '76.

04-02:20:52

Harberger:

Yeah. Well, and I came back again in the eighties. [laughter]

04-02:20:58

Burnett:

So in a sense you've sort of grown along with the policymaking of that country.

04-02:21:02

Harberger:

Yeah. It certainly is a big help to have that kind of connection and in the process you have connections with people, with key people, people who later become planning directors and ministers, that you knew when they were just returning graduate students or something like that and you see them gain in experience and wisdom over the years.

04-02:21:42

Burnett:

Yeah. Well, in histories of international development and even the *Pinochet's Economists*, there are these descriptions of USAID, the World Bank, and the IMF as these forces that want x , the institution wants a certain kind of capitalist development out of these countries. But when I think of your stories I think of Chicago economics, I think of you training your students. I think of your students then going on to work for the World Bank as chief economist for Latin America, for example. So could you talk about this circulation of the approach to good economics as it moves through those institutions? You could read the history of international development as the foundations, Ford, Rockefeller, IMF, and World Bank and USAID, as already having an approach to market-oriented development that they're pushing. How does that sit with you based on your intimate acquaintance with USAID for this long period and all of these other institutions?

04-02:23:02

Harberger:

Well, let's say without a doubt the champion institution is the IMF. Their young economists program starts with roughly 2,500 applicants each year and appointing twenty-five. It's a rigorous thing and one of my great prides is that UCLA is the champion source of the Fund over the last fifteen years. And it's very nice to see those people get there and then be working on key things. One of them, Pablo Lopez Murphy, he really fell into the luck because in this crisis period his first country was Spain for several years and after Spain he got

Greece. [laughter] So if anybody is going to end up with accumulated wisdom, it's he.

04-02:24:21

Burnett: And this is Pablo Lopez—?

04-02:24:22

Harberger: Lopez Murphy.

04-02:24:23

Burnett: Murphy.

04-02:24:23

Harberger: He is a PhD of mine from UCLA and his father was a PhD student of mine in Chicago. And his father is part of our group that meets every February in Alamos, Mexico and so on. So I have continuing relationships with the father and also with his son. It's wonderful.

04-02:24:51

Burnett: So I guess to restate the question, if the consensus on development wisdom is these elaborate econometric models, state-driven, focused on industry as opposed to agriculture, and not necessarily focused on integration with global markets, per se, is it fair to suggest that the IMF and the World Bank economics expertise likewise undergoes a shift that is roughly coterminous?

04-02:25:39

Harberger: No. No, I think that they were on the side of good economics from day one.

04-02:25:46

Burnett: From day one?

04-02:25:47

Harberger: Yeah. I don't think that they were into the two-gap model or anything like that. They actually were inventing the monetary approach to the balance of payments in the 1950s.

04-02:26:01

Burnett: Well, could you talk about that, then, because there's this academic economics that everyone is talking about and then there are these institutions that are acting out global economic policy. Where is that training and knowledge coming from? Who are these people at the Fund in the mid-1950s who are making good economic policy?

04-02:26:31

Harberger: I was telling you about the two-gap model and how in the two-gap model, if the trade gap is the binding gap, the model could sometimes tell you that an extra dollar will permit an extra dollar of imports and since imports are 20 percent of GDP, GDP will go up to five times that dollar. That's kind of the stupid stuff that they were peddling. And it came out of mathematics with rigid coefficients and so on. The math wasn't wrong. It was the assumptions

that were built into that math that were wrong. Well, anybody who took a good old-fashioned course in international trade would know better than that and everybody knew that protectionism had serious ill effects for the countries in general. What you were doing was you were not going to the cheapest source, you were going to a more expensive source.

I can tell you a story from China that I love. This is '83. The World Bank sent Nicholson and myself to China to give a course in project evaluation in both Beijing and later a shorter one in Shanghai. And in Beijing our students were functionaries of the two big banks, the China Development Bank and the China Investment Bank. Out of a population of one billion they were culled and culled and culled and culled, so these were people who were super smart. And we would have kind of a cafeteria style lunch with them. And a few who knew English better than others would come to our table and would talk to us. If you looked at Beijing's streets at that time, the car that you saw most often was a current version of a 1942 Pontiac. They had bought an old Pontiac factory to make that car in China. Well, it was two tons in weight and getting eight miles at best to the gallon and having a lot of fumes and all of that, but there it was. Side by side with those you saw a few new Toyotas floating around. Well, at one of these lunches these two guys came up to us and said, "We started looking at this automobile industry and at the resources that we use in this industry for each car that we build. And what we figured out was that if we took that value of resources and put it instead into shoes and textiles and clothing, and we exported those things to the world market, with the proceeds we could buy two new Toyotas, which are much better cars in the first place. That is the principle of comparative advantage that they discovered by thinking through this anomaly in the Chinese economy. Well, I'm saying that people who had good training in economics in 1900, in 1910, in 1920, in 1930, all knew about the virtues of free trade and the vices of protectionism and the inefficiencies involved and so on. So these are the people who were populating the Fund and bank at that time.

04-02:31:33

Burnett:

And this is your affinity for real-world economics and real-world economists. These are the people you like to work with.

04-02:31:43

Harberger:

Absolutely. [laughter]

04-02:31:48

Burnett:

The rich engagement with real problems and real puzzles that are more interesting because they have this impact but also interesting because they present surprising puzzles.

04-02:31:59

Harberger:

And I think the accumulated individual and institutional experience of the Bank and the Fund to a degree. No, pardon me, the Fund. The Fund is the

better one, “to a degree” applies to the bank. But they just accumulated a lot of real-world experience to reinforce their good economics.

04-02:32:35

Burnett:

And you did the consulting for Panama and a number of other countries. You were a consultant for the Organization of American States. Was that exclusively for Panama or were there other countries?

04-02:32:50

Harberger:

Oh, I honestly don't remember. Let me just tell a couple of stories. Mexico. In the government of Echeverria, which was something like '70 to '76, I was asked to come down in around the middle of his term. He was a big spender type of president and not very popular with our guys. But I was asked to make this big public lecture with titans of industry and people from the press and leaders of the government, all present. The punchline of this was that I came as a country doctor there and I said, “This patient is suffering from a grave problem in the lungs that if continued may easily turn into double pneumonia.” And the story was that in the balance sheet of the central bank the obligations of the government had gone up from like 30 percent of the balance sheet to 70 percent of the balance sheet in just three years. And I said, “This cannot go on for the next three years, because in order for it to go on for the next three years it would have to end up at 110 percent of the balance sheet by the end.” So there was a definite—

04-02:35:14

Burnett:

Limit.

04-02:35:14

Harberger:

—serious limit and contradiction. That was supposed to be a wakeup call to them to get their act straightened out. Another similar episode was in El Salvador around '78, '79 or something like that. There had been this huge coffee boom and this was leading to a lot of money coming in. A Dutch-disease situation. And they were perceiving inflation as a consequence of that. And I, with my antennae working on the monetary approach to the balance of payments and so on, I said, “Suppose you are in your house and it's a big house. Stairways and doors and windows. And all of a sudden you find there's a tiger in this house. And you're wondering what the hell to do about this tiger in the house. What is my advice? You open all the doors. You open all the windows and give the tiger every chance to escape.” And the idea was if they opened themselves to trade and stopped the unnecessary protectionism and so on, some of this excess money that's creating internal inflation is going to flow out and put them in better shape. So that's another sort of simple lesson of economics in a situation at a time where they're supposed to learn the message.

A somewhat similar thing happened in El Salvador later on when, starting in '88, I was asked to build up a team to study the Salvadoran economy prior to a presidential election which was going to take place eight months ahead.

And so I created this team, mostly of my former students. Ernesto was there. Juan Carlos Mendez was there. Dan Wisecarver was there. Schenone was there from Argentina. I think Maria Teresa Infante was there. She's a lady minister from Chile, former Chicago person. So we were there and we met with all the presidential candidates and we met with all of their economic teams and we met with the representative of sectors, the agricultural sector, the manufacturing sector, the commercial sector, and so on. With the export-oriented sectors in general, but particularly the agricultural one, they couldn't understand how the Central Bank could be so dumb. The exchange rate was five colones to a dollar. And at that exchange rate they were having a hard time with their exports. They were thinking of going out of business. They didn't know what to do. They couldn't understand. If the Central Bank would only make that exchange rate eight or ten they would be in clover. And why was the Central Bank so stupid not to do that? And I had to try to explain to them why that wasn't necessarily a good idea for the Central Bank to do it for such a purpose. Their problem came from the cheap dollar. That they earned dollars with the export of coffee but the dollar was so cheap that it didn't give them much to pay their workers and to have residual profits and all that. So I said, "Well, why do you think the dollar is cheap?" I said, "The dollar is cheap for two reasons mainly. Something like 5 percent of your GDP is coming in the form of foreign aid. And something like five to ten percent of GDP is coming in the form of remittances from your compatriots who migrated mostly to Los Angeles." Actually, El Salvadorians in Los Angeles had a higher GDP than El Salvador altogether. So anyway, what I said was, "If you want to have an expensive dollar you've got to make the dollar scarce. How do you make the dollar scarce? Well, you tell your government, please, the next time AID people knock on the door, send them back home. Don't take that money. And you tell your friends who have relatives in Los Angeles, 'Look, you can pay a tuition for our kids when they go to school at UCLA but don't send the money here.'" And, of course, nobody would dream of actually implementing such advice. But try to tell them that unless they did something to stem that great flow of dollars, the dollar is going to be cheap in real terms after they raise the exchange rate. And, indeed, something like that had in fact happened in a prior time when they raised it from 2.5 to five. It took eighteen months for the general price level to double and they were right back in the same situation.

So these are examples of simple economics, looking at a problem, understanding where the problem is coming from, diagnosing the problem, and then transmitting the message that comes from that diagnosis. And that's the style of economics that I think helps in trying to work in an alien environment, so to speak. You're really trying to understand the basis of their problem first.

04-02:43:09

Burnett:

Right, right. And these are widely divergent versions of economies. El Salvador is largely an agro-export, mono-export, effectively, country, compared to Chile, which is kind of middle-level, quasi-industrial country.

04-02:43:29

Harberger:

And Panama is unique because of its canal.

04-02:43:31

Burnett:

Right, right. And there are these special cases. But one of the common denominators that you bring to the table is this appreciation for the vicissitudes of international trade, especially during that time. You were quite aware of the changing fortunes of the United States, the petro-dollars that were coming into American banks that were then in turn being lent out. How quickly was that problem understood? Because that's the kind of classic narrative of the debt crisis in Latin America. Who sounded the alarm with respect to petro-dollars coming into American banks, then in turn being lent out, and that causing downward pressure on standards for lending?

04-02:44:27

Harberger:

I don't remember alarms at that point. The move from 1979 to 1981, which is when this petro-dollar flow was coming in—everybody was in clover, so to speak. The Chilean growth was over 6 percent per year. Argentine growth was quite good. Mexico, it was an oil-exporting country but it performed a record because not only did they use up the full proceeds of the oil boom instead of keeping some abroad in order to bring it back at a more expeditious time, they not only consumed all of that but they borrowed in order to mortgage the future revenues of this kind, so that they ended up having excess expenditures three or four times the proceeds of the oil boom. And they built all over the place. This was public sector, you see, the Mexican oil industry was public sector.

04-02:46:04

Burnett:

PEMEX. Yes.

04-02:46:04

Harberger:

Pemex. And it was just wild. Mexican states have governors who are quite powerful, especially in the era of the PRI when they were ruling Mexico. They were called the old dinosaurs and they were all for public spending on this and that construction. The old ex-governors, the previous ones, were dinosaurs now. They had construction companies and engineering companies and concrete manufacturing companies and all of that where they were profiting from this big flow. So I made a certain impact by going around Mexico and get to the airport in Monterrey, and walking through the airport in Monterrey, I said, "Gee, I bet this was built around 1979, '80." "How did you know that?" "Well, you see that black marble on the walls there? You see these beautiful murals? You see this, you see that? Somebody spent a lot of money on this. And when did they have the money? It was then." And then I would go in Aguascalientes and look at the big kind of a civic center that they

had built. And also beautiful gardens and big buildings and things like that. “I think this was built around 1979, 1980.” “How did you know that?” And so I had a lot of fun with that. [laughter]

04-02:48:15

Burnett:

So you’re looking at these individual cases on their individual terms but you’re also paying attention to what’s happening in the global marketplace. And you are also a consultant for the International Bank for Reconstruction and Development.

04-02:48:38

Harberger:

That’s the World Bank.

04-02:48:40

Burnett:

Yeah, that’s for all of those, for specific projects in the same countries that we were talking about or they were separate?

04-02:48:48

Harberger:

No, I don’t remember really. I can’t separate out who was paying for which visit. But with the World Bank, where I was big in the World Bank at that time, over those years, was even starting in the sixties. They had a project evaluation course within the World Bank and they gave an English course and a Spanish course. And I was asked to give lectures in both of these courses but more intensively in the Spanish course because the ones that they got besides myself in the English course couldn’t speak Spanish. So I had a very heavy load in teaching the World Bank Spanish course as long as it went on. I don’t remember, it went on well into the 1970s. And that was a very big thing. During this time I spent a whole quarter as a visiting professor at the World Bank in this same connection.

04-02:50:07

Burnett:

Okay. And I don’t think we talked about the Ford Foundation supported summers in India in ’72, ’73.

04-02:50:19

Harberger:

Well, that was interesting. Harry Wilhelm had been my benefactor in financing the Center for Latin American Economic Studies in Chicago. And we became friends in the course of this and then all of a sudden Harry was made the Ford Foundation representative in India and so he asked me to come for the summer or for a good part of the summer. And I actually did that in these two consecutive years, ’72 and ’73, and was deputed to the planning commission at that time. It wasn’t a 100 percent dedication, as had been the MIT project where it was sort of earmarked to be with the planning commission. But in any case, I worked on economic policy matters in India both of these years. We were making modest dents in the structure. The process of liberalization, I’d say, from 1960 to 1990, was very gradual. It just was peeling off one thing and peeling off another.

04-02:52:29

Burnett:

Well, it's during that time you have a paper that comes out. It's kind of a critique of assistance, capital assistance to lesser-developed countries in 1972. And it argues against sector loans and program loans as opposed to project loans. Is that where you're beginning to have small interventions into how lending is undertaken?

04-02:53:08

Harberger:

Well, it's the same old story in a different light. You talk about one of these big models. How does the model become big? Well, if it's a middle-sized model it has the manufacturing sector, the agricultural sector, the transport sector, and the services sector, et cetera. The power sector maybe. They'll have five sectors. Well, it gets a little bit bigger and then it'll have twenty manufacturing industries and similarly, so over this bunch it might have sixty, seventy separate industries. And the idea is that you have a policy that says, "Well, we're going to favor this sector or that sector and somebody has a dream about such a sector." And I say, "It's crazy." The road transport sector, you have road projects that make sense and you have road projects that don't make sense, so don't go around saying, "We want roads." You say, "We want projects that meet these conditions that show that they're good investments." And the same thing goes all the way through. You say, "We're fostering industry." What kind of a label is that? Even "we're fostering clothing." There are plenty of dumb investments that we've made in the clothing industry and God only knows restaurants. There's no industry that has more failures, a larger fraction of failures than restaurants, because people think the wife is a good cook and they say, "Well, all we have to do is set up a restaurant and the world will beat a path to our door." And they don't.

04-02:55:15

Burnett:

This paper is about, to some extent, the poor lending criteria for foreign aid programs and that one wants a sort of more specific set of criteria for each project. And one of the big bugbears at the tail end of the seventies is this private lending from American banks to Latin America, let's say. But you're also interested in fiscal reform in these countries. There's a 1974 Brookings Paper, "Fiscal Policy and Income Redistribution," which is a general paper, not just for lesser developed countries. But you're quite aware of the drive for income redistribution, that social justice is a big part of the values of economic policy in all of these countries. And you have a number of constructive suggestions for reducing inequality that you talk about: various kinds of tax reform and ending of housing subsidies except for the truly needy. Is this because in your experience, you've encountered a lot of sort of state—

04-02:56:46

Harberger:

This is a scandal of the United States from day one. Remember that we have had the deductibility of mortgage interest for as long as I can remember. Okay. So when we had a 91 percent rate the government was subsidizing Rockefeller's housing 91 percent. And then it went down to a 70 percent rate,

which it stayed for capital income. For labor income it stayed at 70 until Nixon's time and for capital income it stayed until Reagan's time. Seventy percent of subsidy to the very rich for their housing, you see. And so it always seemed anomalous to economists that this deductibility of mortgage interest was not recognized as the subsidy that it really was. And a subsidy that was utterly regressive in the sense that the richer you were the bigger the subsidy. [laughter]

04-02:58:13

Burnett:

Other specific things. The electricity subsidies, power subsidies, which obviously has some kind of goal behind them.

04-02:58:21

Harberger:

Well, power subsidies, that's another whole other story but it has again a real-world aspect. In India both times that I was there this power issue was a big issue. Most of the power was generated by state-owned power companies but not by the central government state but by Maharashtra and Bihar and Madras and whatever. Each state had its own electricity enterprise and they tended to want to keep the price of electricity low. In the process of having the price of electricity low they had a hard time getting financing from international sources and so their electricity was always running behind the rest of the economy and the end result of that were brownouts and blackouts taking place all the time, which weren't doing any good for the economy, you see. And these low prices were low prices. They would have been way better off by charging true economic prices that covered all the costs, including the interest on the loans from abroad and so on and provide energy as people needed it. And to get that message across was like pulling teeth. Worked fine with economists.

04-03:00:28

Burnett:

But in these real-world cases that could be more of a challenge. And there are a number of other claims. And, again, there's this human capital dimension. So you're advocating ending free university for mostly the elites, who were the only folks who were going in most cases.

04-03:00:49

Harberger:

Well, that is another kind of scandal, that Latin America in particular was very fond of having free or very heavily subsidized university education. And they had good universities, like the University of Chile, Catholic University, and so on. What happened was that who got into these universities were people who had gone through private schools all the way from kindergarten through secondary and were the children of the elite and they get to university and they get this very subsidized tuition. Economists noticed this quite early and kept calling attention to it and saying that it would be sensible to have tuition and fees that covered the cost for those who could afford it and save your subsidies for the people who really need it.

04-03:01:52

Burnett: Right, right. So along with this you were advocating expanded student loans, means tested student loans?

04-03:02:01

Harberger: Sort of, yeah.

04-03:02:01

Burnett: Yeah, yeah.

04-03:02:05

Harberger: Or even free tuition.

04-03:02:06

Burnett: Right, right. And one of the other pieces that I think we've spoken to before, but it might be interesting if you've got any anecdotes, that the government should be the employer of last resort, not a model employer, that is, giving them the best benefits or the highest pay in a given sector.

04-03:02:27

Harberger: Yeah. Well, that's an interesting question. See, the question is how do you deal with recessions and things like that. It's more than common, especially among developing countries, that public sector jobs are created to absorb actual and potential unemployed. So what happens is that if these public sector jobs are reasonably well-paid, they never go away. The people, they get the job and they want to keep it and political pressure is generated so that they do keep it. And what I was referring to there was that if you're going to have anti-recession purposes, do like the WPA in the United States. The WPA paid fifteen dollars a week, I think, which was enough to buy your food and stuff like that, but certainly not a job that anybody wanted to keep. They tried implementing this in Chile during the recession periods in seventies and eighties with somewhat mixed success. In one case it paid very low wage and what happened then was that people came out of the woodwork, so to speak, to work at this low wage. They had cripples and grandmothers and all kinds of people coming to work at this wage. And did they do any serious work? No, not really. And their bosses would oversee them in their work, whatever it may be, and the saying was something like, "For each pittance they pay us, they get a pittance of work." [laughter] So it was not really a success. And in Chile they ended up having a new program for heads of households to sort of filter out these interlopers, so to speak, into the program that were not genuine members of the labor force. That may have had a somewhat better record of success.

04-03:06:00

Burnett: So it was more economic to have a welfare payment. Yeah.

04-03:06:03

Harberger: But in any case, my position is that if they have something so low that it causes the pittance story to get into the picture, that's probably too low. But something like the WPA level I think worked quite well.

04-03:06:23

Burnett:

Right, right. This is kind of basic policy wisdom that you're writing up in the mid-1970s, which means that lessons have been learned from long experience. And I think you're actually dating some of this, basically including all of the 1960s and the beginning of the 1970s. There were just a couple of projects that I wanted to ask you about during this time. There was the Indonesia consultation in 1982. So I'm imagining that has something to do with what we've been talking about on the world stage.

04-03:07:09

Harberger:

Yeah. Well, the Indonesia thing was really interesting. First of all, Malcolm Gillis, who has very recently died, he did his PhD at the University of Illinois in public finance. And I first met him when we were both in Colombia at the same time under different auspices. We bonded quite quickly and became very good friends and very good allies on economic issues. So he had been the Harvard HIID or DAS person in Indonesia for a long time. And I credit him with being the economist with the highest marginal product that I can identify, so to speak, and I really, truly believe that during the period of the Indonesian miracle, when they had like six, seven percent growth rate, that last percentage point would not have been there but for Malcolm. And it was his personal connection with the key ministers, that he could tell them, "How can you say something so stupid?" and they would listen to him and take it seriously. That was the big contribution, I think, that he made.

Well, around early 1980s the government wanted to have a major tax reform and they asked the Harvard people to help them in this. And Malcolm, being very wise in the ways of the world, said, "Well, we have to have a commission." And he assembled maybe twenty of us from all over the world, from Norway and Netherlands and Britain and Italy and other countries, and we all assembled in Jakarta for two consecutive summers studying the Indonesian economy and interacting with the Indonesian counterparts and learning a lot about things. And then we wrote up our respective reports. And the end result was a set of recommendations that I could have written in advance and Malcolm could have written in advance. So what was all of this charade about, of all of us going there? Well, if this comes as a piece of foreign advice, from people from the outside who don't really know our economy, it's not going to get anywhere. But if you have these leading scholars from all over the world dedicating two summers to understanding Indonesia and interacting with the public sector and the private sector and learning about our economy and then they come to this conclusion, we are much more ready to accept it. And that was indeed the case. It was Malcolm's savvy that led to this happening.

04-03:11:15

Burnett:

It wasn't anything revolutionary beyond the normal advice that you give for fiscal responsibility and reform?

04-03:11:43

Harberger:

What are the general rules in taxation? You don't want stupid protectionism. If you're going to have tariffs you like them to be uniform. And in the tax area it's pretty much the same. The value-added tax has proved itself to be not a perfect tax by any means but a much less distorting tax than most of the others. So you want to have heavy weight on that. And things like that. I wrote on indexing in my second year there and that didn't win out but it was something that most public finance people familiar with the way inflation screws up issues of taxation, immediately see the virtue of having a tax system that's indexed for inflation and so you neutralize this distorting effect that inflation has.

04-03:12:43

Burnett:

Right. So one of the things that I have down for the early 1980s, there's this work that you're doing on the open economy stuff. Is that related to the Harry Johnson work that was done in the seventies?

04-03:13:11

Harberger:

Well, how can one say? I would say more likely not than yes. Open economy macro-economics is one sort of thing and the nature of economic adjustment, thinking of the world in terms of tradable goods and non-tradable goods, that is the monetary approach, Harry Johnson, Dornbusch, Frankel, Mundell line of thought. The open economy story that was occupying me at that point was simply to think of each developing country realistically as being a small economy in which openness to the rest of the world is definitely a plus if they know how to do it well. And, well, how do you best organize these linkages of this small open economy with the rest of the world and how do you arrange your tariff policies and other policies in such a way as to deal with it? I don't remember exactly what's in that paper but certainly today I would add—let's say Chile has developed a copper fund and what does the copper fund do? It accumulates resources abroad in times when the price of copper is high and it draws on those funds at times when copper is low. Well, that mitigates the copper cycle—especially by moderating the ups and downs of the real exchange rate that stem from big savings in the world price of copper. And unlike some cycles in business, you really pretty much know when the price of copper is high and you pretty much know when the price of copper is low. So that you're not likely to stupidly misrepresent a situation in that way. So between maintaining an exchange rate that is ready to adjust when issues of supply and demand call for it to happen, having a tariff policy that is as neutral as you can make it, and if you have volatile export issues, to try to mitigate the effects of that volatility by accumulating abroad at good times and decumulating from abroad at bad times. Those are three simple rules, so to speak, that can help guide a small open economy.

04-03:16:53

Burnett:

And turning to Argentina, which had the education project from '62 to '67, right? Were you involved in consulting for Argentina after that?

04-03:17:20

Harberger:

I did a lot of work for Argentina. I remember at the very time of our project I was working on something in taxation in Argentina, which had to do with the issues surrounding tax evasion. And I remember one of the exercises I performed was to go back in time and make the assumption that the income distribution, relative income distribution of Argentina, didn't change through time. And these were times maybe five years or seven years apart, where you wouldn't expect major transformations of the distribution of income. And what I basically did was say, "Suppose that in, say, 1959 we had the same degree of compliance as we had in 1954, income bracket by income bracket. After adjusting for the necessary changes in rates, how much more would we have collected?" And it turns out that evasion got a lot worse between 1954 and 1959. Then I made another step to a still later period and again it got worse. And what was happening was that the government would have certain rates and it would need more money so it would raise the rates. Well, when it raised the rates there would be more evasion. So then they would raise the rates again and there would be still more evasion. That was the story that I was able to tell about how the Argentine system was working. But then later on in the nineties, I don't know if you want to get into that yet but—

04-03:20:02

Burnett:

Let's put a pin in that. For Argentina?

04-03:20:07

Harberger:

Yeah.

04-03:20:09

Burnett:

If it's directly connected to this. Is it?

04-03:20:12

Harberger:

Well, no, no. Let's say Argentina in the nineties, I am helping with training of economists in and out of government.

04-03:20:30

Burnett:

One of the things that's also part of that 1974 Brookings paper, "Fiscal Policy in Income Distribution," is this caution about taxation in developing countries in particular, and evasion is at the top of the list. You can evade taxes, you can move your resources out of the country, capital can leave an entire industry. Your caution is about how not to tax. And one of the pieces of advice that you give is to keep the rate below a certain amount to at least discourage evasion, right? If taxes are evaded or if an individual can evade in a given way, if a corporation can evade or if an investor can move capital from one industry to another, how best can a state get revenue? What's the most reliable and non-distorting—

04-03:22:06

Harberger:

Well, I think there is a basic consensus that value-added taxation and a uniform rate is not totally non-distorting because there are many activities that—typically even a very general value-added tax is not going to tax

hospitals, for example. You aren't going to tax hospitals, you don't tax medical services. Are you going to tax educational services? You go down the list and you find that there's a fair chunk of the economy that is not being taxed by this supposedly general value-added tax. So the idea that it's perfect across the whole GDP and doesn't distort it at all is crazy. But the idea that a uniform tax on a very broad base has a small so-called Harberger triangle connected with it is correct. That's one direction in which you want to go to avoid evasion. Imports, a uniform tariff, is so much more sensible than one that has a lot of variation in it. The story I tell there is that the tourist is coming in with a major item that they bought in New York and are bringing back. And the dumb customs officer says, "Give me a hundred bucks and I'll let you pass through." And so he doesn't register any tax for this item. And somebody's going to catch him pretty soon. Smart customs person says, "Well, we've got category seventeen, has a tax of 20 percent. Category sixty-two has a tax of 40 percent. Category 113 has one of 100 percent. And 225 has one of 200 percent tax. Now, I can classify this in any of these four categories. What do you suggest?" So he gets a side payment from the guy and he subjects it to tax. So it enters and it's recorded. How is somebody going to catch that? But if you have a uniform tariff, such a ploy won't work.

04-03:25:13

Burnett:

Right, right. So you're thinking about taxation as games, right? You're thinking about them as scenarios where you have to—

04-03:25:23

Harberger:

Well, I'm thinking about it as life. This is what happens. [laughter]

04-03:25:31

Burnett:

[laughter] Fair enough. But you're thinking about them as real live people gaming a—

04-03:25:38

Harberger:

Yes, absolutely. Absolutely.

04-03:25:39

Burnett:

—a system. That's kind of what I mean. Yeah. So along the way we have not kept track of a huge part of your life and that is the last time we spoke of anything like this was the late fifties when you got married to Anita and you went on a honeymoon. And so now we're in the late seventies, early eighties. Can you talk a little bit about family and what happened and new additions and so on?

04-03:26:19

Harberger:

Well, it didn't take too long. We were married in '58. Paul was born in July of 1960 in Santiago, Chile, and Carl was born in October of 1961 in New Delhi, India. So we have two foreign born members of our family. They both acquired American citizenship directly at that time because Anita had had her citizenship accelerated because of my links with AID programs.

04-03:27:00

Burnett: Right. It makes it easier.

04-03:27:01

Harberger: Somehow it made it possible for her to get to be a citizen on an accelerated basis.

04-03:28:08

Burnett: Sure.

04-03:27:09

Harberger: So anyway, that was that. The great thing about family life, so to speak, our family life, was the degree to which our kids traveled with us everywhere and all the time. And when they were just tiny, I remember we were in a hotel in Panama with a huge swimming pool and they were just going great guns in this huge swimming pool in Panama. And then in India, when we were there with the Ford Foundation, that would be '70, about '70, they'd be—

04-03:28:03

Burnett: Seventy, seventy-two.

04-03:28:04

Harberger: —twelve years old, that kind of thing. And we were staying in the Ford Foundation guesthouse and behind the Ford Foundation guesthouse was the Lodi Gardens and there were the Lodi Tombs in the Lodi Gardens and they would go out at night and then the Lodi Tombs, there would be these huge bats. Scary things. All kinds of things. Anita and I went into Lodi Gardens at one point in those visits and we saw an Indian swami come up after having being buried underground for fourteen days. Fourteen days and nights buried underground. And he came out and he was sitting cross-legged in front of us and a whole crowd of people around him. And he was handing out seeds. People would go past and hold out their hand and they would get seeds and petals that he would give to each one. And the question is how could he possibly survive fourteen days underground? Well, and the answer was he was in a hole about one foot square or maybe fifteen inches square standing up and sort of squashing himself down and he had a layer of maybe six inches of loose dirt over him. So air filtered through this loose dirt and he was able to put himself in a semi-somnolent state of low bodily activity and actually he did survive fourteen days under there and he had this beard. His beard was mainly curls with cow dung that tinkled when he shook his head. [laughter]

04-03:30:15

Burnett: And that's right outside the Ford Foundation house?

04-03:30:17

Harberger: This is within 200 yards of the Ford Foundation guesthouse, yeah.

04-03:30:22

Burnett: What city was that in?

04-03:30:22
Harberger:

In New Delhi.

04-03:30:22
Burnett:

In New Delhi. Okay.

04-03:30:25
Harberger:

So this is a part of the kind of joy we had as a family in experiencing these sorts of things. We went to Brazil. That was the time when Mario Simonsen, who had been head of the *Fundação Getúlio Vargas*, became minister and Langoni who was my former student, took on the headship of the graduate school at *Getúlio Vargas* and that's when I was called the visiting professor with tenure because I came every summer to *Fundação Getúlio Vargas*. So our kids would have been fourteen years old or something like that. I remember one time we were out, Anita and I were out for dinner, and the kids were old enough to stay in the hotel by themselves. And so we come back and they're not there and we get kind of worried. But after not too long they come back and I said, "Where the hell were you?" and they said, "We were out on the beach." "What were you doing?" "Well, on the beach they had these macumberos that were doing macumbas with dolls and poking them with needles and doing all kinds of things like that, these magic incantations, and they were there watching these incantations of voodoo on the beach while we were out with Og and Cristina Leme for dinner. [laughter]

04-03:32:25
Burnett:

Were there ever any concerns about safety when you were in Chile, for example, or other places? Did you have to worry about that?

04-03:32:35
Harberger:

We were more concerned about safety in Hyde Park. The kids never owned a bicycle that did not end up being stolen. It was a hundred percent certain that every bicycle would be stolen. The only issue was would the bike be stolen when they were on it or would it be stolen when it was parked. And they were half and half between them. So we were within two blocks of the ghetto in Chicago, Forty-Seventh Street being the boundary. We were 4840. But we had a certain level of security in the immediate surroundings of our house because Elijah Muhammed, the head of the—

04-03:33:38
Burnett:

Nation of Islam.

04-03:33:38
Harberger:

The Nation of Islam, yes. He had his mansion at Forty-Ninth and Woodlawn. That was one street away. It was Greenwood and then Woodlawn. So he was only a block away and in front of his house there would be these six-foot-six bodyguards, always impeccably dressed with ties and stuff like that. As far as we know no criminal dared to come within three blocks of that home. But Elijah Muhammed had three sons and in the block between Woodlawn and Greenwood there were three identical houses with ample lawns. And one of

these sons had a pet lion that he kept behind a strong fence. We walked past that pet lion many times. [laughter]

04-03:34:39

Burnett:

Wow. I guess they had an understanding with the animal control department or had some kind of license for that.

04-03:34:47

Harberger:

Well, goodness knows.

04-03:34:50

Burnett:

Goodness knows.

04-03:34:51

Harberger:

Chicago politics being what it is, it's easy to imagine. I can tell you another story about Chicago politics. We had this big house and there was a neighbor lady who was aging and living alone in another big house next door, which had a porch. And there was an empty space under the porch. Well, there was a pack of loose dogs, no owner at all, and obviously there must have been an alpha male leading this pack because they all followed and they slept under this porch. Well, our kids at that point were like three, four years old, that kind of thing, and we were worried about these damn dogs, twenty-five dogs of all sizes and breeds and here when the kids just go out of our back door, they're right in front of these dogs. So we called the dog-pound people, they should come. And they came with nets or something like that, but nothing happened. Nothing happened. We called again and again and nothing happened. So finally somebody said, "Call your alderman." So we called our alderman and told him the problem. The next day there were half a dozen people, I don't know whose functionaries they were, but they eliminated that problem completely for us. Guess who we voted for alderman all subsequent times? [laughter] This is old-fashioned Chicago politics at work. And that's the way it worked in New York, in Boston, everywhere.

04-03:36:57

Burnett:

Right, right. That personal touch.

04-03:36:56

Harberger:

Give people what they need when they need it and they will be your friend.

04-03:37:00

Burnett:

Yes, yes. And so they grew up in Chicago.

04-03:37:07

Harberger:

They grew up in Chicago.

04-03:37:09

Burnett:

And traveling with them was a deliberate choice on your part, because not everyone does that. Not everyone takes their kids with them.

04-03:37:16

Harberger:

Oh, Anita had a somewhat selective memory. The way she tells it is that she said, "You can go away one day, two days, three days, but four days we all go with you." And she told that story so many times that she actually believed it. But it wasn't true. That I had a rule of my own, which was I definitely kept my absences to less than 100 nights per year. That wasn't all three-day, two-day stints. I was in Brazil for two weeks on some periods, and they were back home and so on. But in any case, on any big summer trip in particular, when they were not in school, they always came with us. Always.

04-03:38:22

Burnett:

Right. Must have been a wonderful education for them.

04-03:38:25

Harberger:

And that's what they say, too. There's no question that they really, really thrived in every dimension with all of these travels.

04-03:38:40

Burnett:

That's wonderful. And I guess we'll pick up the next generation and things later. So just to end off this period, there was a list of—well, perhaps we can actually leave that for next time. But essentially you had done just an incredible amount of consulting that continues on into the 1980s and the 1990s and we'll continue on in our next set of sessions to discuss that.

04-03:39:35

Harberger:

Fine.

[End of Interview]

Interview 5: March 1, 2016
Session 5A, Morning

05-00:00:10

Burnett:

This is Paul Burnett interviewing Dr. Arnold Harberger for the Economists Oral History Project with the Oral History Center at the University of California Berkeley in collaboration with the Becker Friedman Institute at the University of Chicago. And this is our fifth session, March 1, 2016, morning session. So last time we talked, in the fourth session, we were talking about the economic crises in the 1970s and shifting patterns in lending that ended up getting a lot of developing countries into some financial hot water. So I was wondering if there's a way into talking about that, perhaps with a specific country. I know that you did a lot of advising with Uruguay. And I'm wondering if you could talk about your involvement in consulting and advising for that country.

05-00:01:21

Harberger:

Okay. Well, Uruguay was an interesting case. They had had an almost stagnant GDP for a long, long time. They considered themselves the Switzerland of South America and they had a lot of social-type legislation. But there was no growth emerging from that scene. It was a very quaint, wonderfully quaint, environment. Their tax treatment of new cars was so prohibitive that you hardly saw a car newer than the 1920s or thirties on the road.

05-00:02:17

Burnett:

Really?

05-00:02:18

Harberger:

And I would go around taking pictures of cars. Ford Model Ts were common. Ford Model As were even more common. They were from '29 onward. The four door Fords and Chevys that came in the late thirties were there. It was wonderful. They had their version of a Champs-Élysées in one little coastal riverbank town. We stayed there a lot. It reminded me of my youth on the Jersey Shore, where you'd go walking along and there would be people selling ice cream cones and people walking and licking the ice cream cones and chatting. It seemed fifty years out of place. And then when finally the liberalization took place, the automobile fans from all over the world came like vultures and sucked up all those beautiful old cars. So within a couple of years you couldn't find [laughter] any and the old sweet atmosphere had disappeared.

05-00:03:50

Burnett:

So there were really high tariff barriers and all kinds of import restrictions?

05-00:03:53

Harberger:

Oh, terrible, yeah. They tried to create an incentive to have their own car, the Indio. This was a country of a couple of million people. Not one to enter with a car factory or something like that. So the Indio was just really an assembly

plant and it turned out that by the time they bought all the parts, put them together in Uruguay to make the Indio they had paid out more than it would have cost to buy a better car in the international market. [laughter]

05-00:04:35

Burnett: Was that in collaboration with Chile? Was there something about the Indio—

05-00:04:36

Harberger: No, no.

05-00:04:38

Burnett: —and Citroën were working together? [ed. note: the domestically produced Chilean automobile based on a Citroën design was called the Yagán]

05-00:04:40

Harberger: I don't believe so.

05-00:04:42

Burnett: Okay. So they tried to have a domestic auto industry in a country of two million people.

05-00:04:49

Harberger: Yeah. But anyway, it is true that even to this day the Uruguayans have a certain affection for the kind of mixed society that they have evolved over time. And efforts to bring about privatization of major public utilities, for example, when submitted to plebiscite, usually get voted down. I am not in a position to have dug in to see if one of these entities might be quite efficient and the people might be perfectly sensible in voting their privatization down. On the other hand, the people might be just acting out of the ideological premise that this should be a public enterprise rather than turned over to the private sector.

05-00:05:56

Burnett: Is it ideological in a more international sense? Is it a leftist ideological position or is it more of a Latin American Peronist kind of conception?

05-00:06:09

Harberger: Well, I don't know. It's an old-fashioned leftist position. The old socialism was government ownership of the means of production. And under the Labour government, Britain, that really did happen. And Margaret Thatcher turned that around. It certainly has nowhere near fully come back, even under subsequent Labour governments in Britain. And I think broadly speaking, the good left-wing governments of modern times have been pretty respectful of good economics, as I've said many times. I have always supported that fact.

05-00:07:05

Burnett: Right, right. I was reading a book by Robert E. Wood, it's called *From Marshall Plan to Debt Crisis*. It's about international financial institutions in this time period and he was arguing that several things are going on in the 1970s that changed the landscape of lending a little bit and one of them, of

course, is the OPEC crisis and the other is the availability of private lending for developing countries, whereas in the 1960s some of the only games in town were lending from the international financial institutions, the IMF, World Bank, and so on. But in the seventies you have this wash of private capital with lower standards or criteria [for lending].

05-00:08:08

Harberger:

Well, yes, you have to be careful, I think. In the first place what was the big Latin American event of the seventies? It was the Brazilian Miracle. The Brazilian Miracle started in '68, ended in '79, 10 percent cumulative real growth over the period. Coincident with 20 percent inflation per year. It was sort of an anomalous mixture. But certainly that was the best period for Brazil in my memory, and Roberto Campos, whom I mentioned in other contexts, was a key figure in bringing that about. Then other countries took over the lead in growth. The Chilean coup was in '73. Certain reforms in '74. A deep recession in '75 linked to the 1974 oil price spike. And the subsequent collapse after that. Then, by that time, from '75 until '81, Chile was chugging along at a six-plus percent growth rate. Even Argentina wasn't doing too bad in that part of the seventies. So the banks, A, had certain reason to be more optimistic than before, no doubt whatsoever, when this oil money came pouring in, first in 1974 and later in '79, the obvious targets were these new clients in Latin America. And the big international banks came down and they pushed money on to governments when the governments were willing to do the borrowing, and onto banks when the banks were willing to do the borrowing, and even onto other private-sector entities.

05-00:10:29

Burnett:

It's interesting the way some scholars and historians write about the 1970s. There are some agendas, So Ha-Joon Chang has written a book called *Bad Samaritans* in 2000.

05-00:10:50

Harberger:

I see. [laughter]

05-00:10:52

Burnett:

And it's critical of the austerity measures or what he sees as the extremity of the austerity measures imposed on developing countries in the 1980s and 1990s. And it's an argument against the Washington Consensus. And what's very interesting is that he points to some of the success stories from this earlier period of the sixties and seventies as evidence of a kind of state-led growth, export-oriented growth. But he doesn't call it liberal or liberalized government. And so he points to the Brazilian Miracle as evidence of the possibility of a kind of protected, nonetheless export-oriented economy. He points to Brazil, '68 to '75, and Korea and Singapore and Taiwan as these countries that exert control over foreign direct investment. They protect infant industries. And so it's this long sort of love letter in a sense to protectionism going back to the nineteenth century. And it has this division between 1960s and seventies, when you had this kind of orientation and the terrible 1980s

when the IMF came along with austerity measures and imposed all these criteria that don't fit with this kind of earlier growth model. You seem to have a different appreciation and an understanding of what that Brazilian Miracle was. Can you talk about that a little bit?

05-00:12:47

Harberger:

Well, I have characterized the Brazilian Miracle as having sort of its keystone in the attempt to target the real exchange rate. Now the one-liner about exchange rates is the nominal exchange rate can be fixed by the central bank or by the government but the real exchange rate is going to be fixed by the people or by the economy. If the nominal exchange rate is fixed at something and it wants a depreciation, then you're going to get a deflation internally to bring about a real depreciation and if it otherwise wants an appreciation, you'll get an inflation, a rise in the price of non-tradables relative to the fixed exchange rate price of tradables.

What the Brazilians did was they set a target for the real exchange rate and the target was to be an export promotion- type target. No question about it. And they had some kind of a nominal exchange rate at different times, different things, but with the nominal exchange rate as it was they would get excess reserves coming in. They would have too much exports and too much foreign exchange coming in and that would want to trigger an expansion of the money supply, rises in domestic prices, et cetera, et cetera, which they did not want. They did not want that indirect effect on the real exchange rate. How did they respond? They peeled off trade restrictions. So when they had too many reserves they could peel off one, two, three trade restrictions. Next time they peeled off four, five, six, then seven, eight, nine. And I don't know if I told you about that time when, in 1974, Pastore and I were trying to convince [Mario] Simonsen, the minister in Brazil, that he shouldn't stick to that fixed real exchange rate. What had happened was that it was the time of the '74 oil price boom and now they were having, not money coming in but money going out, and Simonsen was putting in reverse what had been done before. Instead of taking off trade restrictions he put on trade restrictions to balance trade, to avoid losing reserves, just as he had pulled off trade restrictions when he *did* want to lose reserves. And we thought that was not really best economics. Best economics would have been at that time to allow the real exchange rate itself to change. And he resisted that, saying that this would be only a temporary event, that they had found oil deposits off the coast in Brazil and when those oil deposits came in then they would have plenty of oil money and if they had devalued the currency then they'd have to revalue the currency and he didn't think that was a good idea. Well, he was sort of right about that but it took a decade or more before this event took place. And it was wishful thinking on Simonsen's part that led him to the action that moulded us.

05-00:17:14

Burnett:

And could you talk about Pastore? Who was this figure that you were working with?

05-00:17:19

Harberger:

Yeah. Celso Pastore, he later became president of the Central Bank. He was a leading figure at the University of Sao Paulo. He was very much a member of our team, so to speak, and Pastore was part of the USAID team that came to Uruguay during all that period. We would be spending Christmas on the beach together with his family and our family, for example. And we brought him to Chicago as a post-doc at one point so I can somehow consider him an indirect student of mine for that reason. [laughter]

05-00:18:01

Burnett:

Okay, right. [laughter] We'll allow you to claim him then. So you wrote an essay once about heroes of yours.

05-00:18:15

Harberger:

"Secrets of success: a handful of heroes."

05-00:18:18

Burnett:

A handful of heroes. So it is a portrait, I guess, of a number of key figures, mostly in Latin America, who impressed you with their boldness in their policy choices. And so it would be good perhaps to talk about that. We can return perhaps to Uruguay because there's a figure that was important to you there, as well.

05-00:18:46

Harberger:

Well, I'm not a crazy doctrinaire Great-Man theorist of history by any means. I do believe that there are social forces in this, and that and the other thing and technological drives that push history in addition to men. But I think most of the time, when good things happen that are very good and when bad things happen that are very bad, there are good guys to credit for the good ones and bad ones to blame for the bad ones and I just cannot help but see it this way. In Brazil things were a misery until Roberto Campos came along, and Roberto Campos was a strong figure and he sort of dominated economic policy over most of that Brazilian Miracle period and did just a great, wonderful job. In Chile, in the first period, from '73 or four to '81-2, it was Sergio De Castro who was the undisputed leader. And after that Hernán Büchi took over around '85 and carried it to the end of the military government. It's hard to imagine those good things happening without the pressure given by those two very good people. In Uruguay it was Alejandro Végh Villegas. He was a Harvard student of Gottfried Haberler and a very good economist and a very disciplined person. He, together with, it's very interesting—the president of the Central Bank was "Gordo Gil," "Fat Gil." But this "Gordo" was Jose Francisco Gil Diaz. And my Gil Diaz in Mexico, Paco Gil, is Jose Francisco Gil Diaz. They have identical names and they're both heroes in their respective countries of this liberalization process. In Mexico they had a harder time, still have a harder time because of the convoluted politics between the PRI and the complicated rules of politics and people not being able to succeed themselves in hardly any job creates certain difficulties. But anyway, the people that I mentioned in that paper were Pedro Aspe and Paco Gil, were

responsible for most of the good things that happened in economic policy in Mexico over that period. I just barely mentioned Domingo Cavallo, because when I wrote that paper he was new in his job. But he was sort of the key figure in the policy of the nineties in Argentina. And without a single doubt the nineties was the best era of Argentine economic policy in my total observation of Argentina, just no doubt about it. And a number of our Chicago people were involved in that as two presidents of the Central Bank, several ministers, and so on.

05-00:22:59

Burnett:

If you took what the economist John Williamson called the Washington Consensus at the end of the 1980s, if you took that ten-point set of criteria, how well do those liberalizations in—is it fair to call it these liberalizations?

05-00:23:21

Harberger:

Yes.

05-00:23:22

Burnett:

In Campos? How well do those fit or are they tailored to very specific political and economic circumstances?

05-00:23:30

Harberger:

I forget, there's kind of a one-liner on the Washington Consensus, external liberalization and internal discipline as being the key features. And I believe that those signals apply well in all of the cases that I've been talking about: Chile with De Castro and Büchi, Argentina in the nineties, Uruguay from '74 onwards, Brazil in the Brazilian Miracle era, and Mexico when our guys—

05-00:25:02

Burnett:

Once they got in.

05-00:25:02

Harberger:

—had some clout.

05-00:25:03

Burnett:

Right, right. You could call it export promotion but they were strategic and there were elements of it that were not necessarily driven by an interest in markets outside. I'm thinking of the ethanol program in Brazil. So there were these large efforts to forge new economic paths that were not necessarily—no one was demanding that so much, although lots of research was being done in the United States. The Brazilians actually *did* it—

05-00:25:46

Harberger:

Well, I haven't studied the ethanol story in Brazil but people tell me it is certainly far less bad than the ethanol program in the States, which is a disaster in terms of both economics and environment, so to speak. Its hidden costs for the environment seem to be big enough to outweigh or at least offset the claimed benefits. You don't have much net benefit once you take into account those costs. Well, the corn land was super-abundant in Brazil and it was cheaper to raise and so on and maybe ethanol in Brazil ended up having a

better benefit-cost ratio than what we have in the United States. But I simply have not studied that.

05-00:26:47

Burnett:

Right. So returning to Uruguay. It's a unique country with a unique history and it starts out being very liberal; it doesn't even have a currency for the longest time in the nineteenth century. And then, starting in the twenties and thirties, it develops this very sort of—

05-00:27:07

Harberger:

Statist.

05-00:27:07

Burnett:

Yeah, statist. And what was interesting about this story with Végh Villegas was the boldness of the moves. Can you talk a little bit about that? There's an element to these liberalizations and there's an element of speed and decisiveness. Can you talk a little bit about the Uruguayan case?

05-00:27:30

Harberger:

Yeah. Well, my memory's a little weak on that. I think this had to do with the currency markets, where there were all sorts of restrictions. You had to go through huge red tape to make almost any currency transaction with any foreign country in any foreign currency. And Végh Villegas passed a decree that, at one fell swoop, just eliminated all of that and sort of broke a dam. Now, sometimes that is not very wise to do. People who try with such bravura, they sometimes pay a high price. But this one worked like a charm and really cracked the barriers very nicely. Uruguay became a true center for Argentina. One of the things that is both a benefit and a burden to Uruguay is that it is so close to Argentina. In Punta del Este, for example, all of the big houses, summer houses and so on, nearly all are owned by Argentines and this kind of investment in the land and spending by these people when they come for their vacation and so on, that's very good. But then again, there's only the Rio de la Plata between the two and when one of the currencies is particularly cheap—when you can buy things cheaper in Uruguay all the Argentines are coming over to Uruguay to buy things and when it's the other way around all the Uruguayans are going over to Argentina to buy things. That can be a pain in the neck for the authorities in either country.

05-00:30:06

Burnett:

I think, going back to the literature that emerges as early as the 1980s, Robert E. Wood's book is '86, and it continues up to the present with Naomi Klein's *The Shock Doctrine* and Ha-Joon Chang's *The Bad Samaritans*, there's a couple of issues that they take with trade liberalization as it pans out in the eighties and nineties, and that is the perception of the removal of state autonomy, right, that they lose control over foreign direct investment, that they lose control, they have to cede control to the IMF austerity measures. And when they point to successful export-oriented economies like Korea, like Singapore—and we can maybe save Singapore for the next session when

we'll talk about Lee Kuan Yew—although these economies were successful and export-oriented, but they were not necessarily liberal. And I don't know if for you that's a complete contradiction in terms. But the way they argue it is that the state remained very much in control of the direction of the economy. They were very selective about the kinds of foreign direct investment that would come in. And that what happened in the eighties was this kind of wholesale ceding of control to the IMF to meet their requirements. How does that sit with you?

05-00:31:50

Harberger:

Well, I certainly don't have a sense of the heavy hand of the IMF. I think there is no doubt that the IMF advice doesn't have a batting average of a thousand, but it has a better batting average than anybody else, by *far*, of any large such entity. I'm certainly not going to knock it. Now, you have to realize that the issue of the so-called lost decade of the eighties was the product of the 1979 oil price boom. There is no doubt about that. The money came from Saudi Arabia, Oman, Dubai, all those rich oil countries with small populations where they dump this money in the international banks. And the international banks brought it down and it was very available. So that by '81 in Chile the inflow was something on the order of 15 percent of GDP. Now, the crisis came for Chile when that 15 percent of GDP inflow fell to approximately zero in '82. Now, I mean, what's wrong with zero? That's balance. But the economy was adjusted so as to be absorbing 15 percent of goods and services more than its GDP. And now it was asked to live on its GDP from one year to the next. And that type of pressure is the ultimate cause of the crisis in every one of these countries, in Argentina, in Uruguay, in Peru, in Mexico, Philippines. So that need for adjustment was there. Well, how does Naomi Klein want you to avoid that austerity? Okay. Just give us 15 percent of GDP more next year. Why not? How can you be so cruel IMF? You see? Well, IMF wasn't giving them the 15 percent. It was the international banks from the Mideast oil countries. The IMF had to help deal with this insistent necessity of bringing imports and exports very closely into bounds when they had them way out of bounds and that had huge effects in all of these economies. Unemployment went up and real wages had to come down. We can show you some pretty good models that show how that basically is true.

05-00:36:03

Burnett:

So there was a larger structural problem in the global economy that precipitated the debt crisis.

05-00:36:16

Harberger:

Yeah, I wouldn't even say a structural flaw.

05-00:36:19

Burnett:

Problem, at any rate.

05-00:36:21

Harberger:

It's one of those things. We've talked a little bit, I think, about the way Norway handles its oil fund.

05-00:36:40

Burnett:

That it has a kind of rainy-day—

05-00:36:43

Harberger:

Yeah. They put all the proceeds of oil abroad, at least so it says here, and then they live only on the income therefrom. So if they're putting abroad 15 percent one year, 2 percent the next, it doesn't matter. You see, they're insulated. And the income is a much more steady flow, and it has little ups and downs but nothing to create big problems. Now, when that is oil money coming out of the ground or from under the ocean that's brand new fresh stuff, the world doesn't know anything about it and if it goes to New York doesn't matter, so to speak. Doesn't create any waves. If you have the money actually coming in in 1981 and then not coming in in 1982, wow. And I must add that in each and every of the countries that were affected by the debt crisis, each country had mistakes in its own internal policy which gave signals to the international banking market that triggered the precise timing of when the international banking market started cutting the flow. But it had to cut the flow in any case. It didn't have money to avoid this. It just was a question of as these flows came down, there would be one country signaling that it didn't deserve it, so it would be cut off first, and then another would give a signal and it would be cut off next, and the others would be given rein to run a little further.

05-00:38:38

Burnett:

Right, right. I'm just trying to interpret some of this critical literature. It seems to have this kind of Keynesian framework, that when times are bad, and this debt crisis was a bad time, the last thing you want to do is impose austerity. You're deflating the economy. What you want to do is have this injection. But what you've pointed to is that there's already been this earlier history of massive injections of capital, massive injections of investment that have distorted things.

05-00:39:16

Harberger:

Well, I would say the true deflation, true deflation is what would occur if you had a fixed exchange rate through this period. And adjusting it in a more easy and plausible way is by devaluing your currency. Well, Chile devalued its currency from 39 up to around 500, I think, before the whole thing was over. But it was a huge devaluation. Mexico had a huge devaluation. Uruguay had a huge devaluation. Argentina went crazy with devaluations, far too much, and too crazy. But the bitter medicine of deflation—not making use of the flexible exchange rate—is still worse. In the end these countries all made use of a flexible exchange rate. Now, Chile was hit hardest. I think I talked about that. They made the mistake of holding the fixed exchange rate all the way until June of 1982. In that process unemployment went up from 8 percent to 25

percent. And I don't know anybody, any good economist, who said that was a good idea. That was a mess that was largely caused by the fact that Pinochet had said to devalue would be suicide. He said that in September and after that nobody dared broach devaluation.

05-00:41:15

Burnett: I'm way out of my depth here, but devaluation on the one hand allows you to pay your debts back more easily?

05-00:41:30

Harberger: No. Devaluation means you have to use more domestic resources to get a dollar.

05-00:41:33

Burnett: Right, okay. But at least potentially you can make yourself more attractive in terms of investment.

05-00:41:46

Harberger: Well, what devaluation does is it draws resources out of the non-tradables into the tradables. So if you have to produce more for export and substitute away from imports, both of them call money into the exportable part and the import substitute part and that shift of resources happens fast. If you think of real wages falling down in order to generate a similar incentive to do that, it takes a much longer time and you get a lot of unemployment along the way.

05-00:42:30

Burnett: Right, right. So there is obviously a whole host of issues that these countries are trying to deal with in the midst of this crisis. There's another context, as well. The 1980s, some historians call it a "Second Cold War" with the Reagan Administration sort of ramping up the rhetoric of evil empire and that kind of thing, as well. So I'm wondering if there is a Cold-War context for some of the international development work that was going on, say, for example, in Central America, which was kind of a hot spot, right? You had the Sandinistas in Nicaragua. There was the whole Con—

05-00:43:30

Harberger: Well, you had the Contras in Nicaragua. You had the coup in Chile, we didn't know of any American involved in the coup at the time, but it was there. Let me think. Earlier there had been Americans jiggering around in Guatemala with the Árbenz regime back in the 50s.

05-00:43:49

Burnett: Yeah, right. In '54.

05-00:44:03

Harberger: So those things were there. I think the intervention of Bush, Sr. in Panama had to do with drugs. Period. The Soviet Union was not involved. It was just Noriega as head of state who was also a drug lord. [laughter]

05-00:44:36

Burnett:

[laughter] Yeah. I think we can all say that was a special case, definitely. So right across the bay from Nicaragua is El Salvador and there were leftist guerillas fighting right-wing paramilitary groups. There were death squads and this civil war from the late seventies until the end of the eighties. And in that time, there was consulting work with USAID—you had talked about this before in an earlier session, about the fact that you had brought some of your colleagues together—

05-00:45:17

Harberger:

Oh, that team came in 1988. And we led up to the election of Cristiani. And Cristiani was the first president of peace in El Salvador. The civil conflict, whatever it was, basically ceased with the election of Cristiani and subsequently we've had presidents in El Salvador who come from the other side. I forget what they're called, the rebels in El Salvador.

05-00:46:05

Burnett:

The FMLN?

05-00:46:05

Harberger:

FMLN? Yeah.

05-00:46:07

Burnett:

Farabundo Martí. Yeah. Yeah. There was a foundation for economic and social development, the Salvadoran Foundation for Economic and Social—

05-00:46:24

Harberger:

FUSADES.

05-00:46:25

Burnett:

FUSADES.

05-00:46:25

Harberger:

FUSADES was a domestic counterpart of USAID. But it also did independent things. It was a little bit like the Committee for Economic Development here.

05-00:46:40

Burnett:

Okay. Oh, interesting.

05-00:46:42

Harberger:

Had top-level businessmen, top level agriculturalists, and so on. Giving their money and giving a lot of their time and thinking deeply about the national problems. I have nothing but respect for those guys who really acted as patriots in difficult times. And it was very interesting that when we went through the Salvador thing, we met with all the presidential candidates and all of their separate economic teams and so on. But we were working with FUSADES because it had this aspect of having offices and working with AID on a lot of different projects and so on. Well, turns out that our counterparts tended to become ministers and central bank people once Cristiani won. So

ours was an extremely successful sort of educative process for these people who later took over the government.

05-00:48:07

Burnett: You know the motto for the Committee for Economic Development?

05-00:48:10

Harberger: No.

05-00:48:10

Burnett: It is, “Neither left nor right but responsible.” So I don’t know if that applies to this case. You had extreme leftist groups, you had extreme right groups and there was a way to sort of—

05-00:48:21

Harberger: Well, no. The FUSADES is not left, for sure.

05-00:48:26

Burnett: No, no, no, it’s definitely—

05-00:48:28

Harberger: When we went in we were as neutral as possibly we could be in terms of dealing with all the presidential candidates.

05-00:48:43

Burnett: There was a *Christian Science Monitor* article in 1989. Now, I don’t know if they’re talking about your team or if they’re talking about FUSADES. But I think they referred to FUSADES as “Los Chicago Boys of El Salvador” and that there was a lot of Chilean-trained economists who were working in or with FUSADES and that that’s a part of the story. You’re saying it’s a kind of arm of USAID with funding from that and the gloss on the article is that they’re hoping to take some of the wind out of the sails of the kind of latifun—

05-00:49:44

Harberger: Latifundista?

05-00:49:45

Burnett: Latifundista-supported super right-wing folks versus a kind of, if you want to call it, neo-liberal approach for export-led growth, diversification of the economy. That was the basic agenda, right? It was the kind of good economics that you were talking about. Tax reform—

05-00:50:08

Harberger: I think that is true. I don’t like the word neo-liberal because it was born as an epithet.

05-00:50:18

Burnett: You might be right about that. Yeah. But as an analytical category, just saying that it’s not nineteenth-century liberalism; it’s a whole bunch of new research. The principles— I don’t want to get back to something extremely general—

the principles that you espoused may happen to accord with nineteenth-century classical notions, but they're informed by research that you and others have done. Empirical research.

05-00:50:50

Harberger:

Yes. Our style has always been that you do things step-by-step. You worry about consequences at each point. When we did this same thing in Guatemala, one of the candidates was a former president of the Mont Pelerin Society, Muso [Manuel] Ayau. And I had this team with Sergio de la Cuadra and Osvaldo Schenone and Juan Carlos Mendez and Dan Wisecarver and lots of people who had lots of experience, former ministers of finance, former budget director, former president of the central bank, all that kind of stuff. And we'd go around to the other presidential economic teams, and they would sort of kowtow to these successful ministers, bank presidents and all that. "What have you got to teach us, dear sirs? We are all ears." We get to Ayau's team, here we're aiming to take this tariff structure, which ranges from zero to 200 percent, with many prohibitions, we're going to eliminate the prohibitions and we're going to squeeze the tariff structure down to the range of fifteen to forty percent. They said, "Why fifteen? Why not zero? Why not zero for everything?" Everything that smelled of a sin in the Hayekian story we got clobbered for. And nobody was saying, "What is the wisdom of that?" But anyway, our approach was to think of getting from here to there by reasonable steps where you didn't set a whirlpool in motion by making too big a step at a given time.

05-00:53:38

Burnett:

Right, right. You have to be sensitive to the political economy, not just the economics but the social side of this and the political side of that. Absolutely. So there was this super-group of highly credible authoritative figures, not just because they had good economics but because they had the chops from having been in office. They had gone through these cycles.

05-00:54:14

Harberger:

Exactly. Exactly.

05-00:54:15

Burnett:

So they understood. And that ended up being enormously valuable for these teams. I'm going to make it a kind of an extreme statement and you can temper it however you'd like. Do you think "good economics" was a Cold War weapon?

05-00:54:59

Harberger:

I'd say absolutely, first of all. Just compare—if you had been to West Germany and East Germany at the time when you had West Germany and East Germany and when you had Austria and Hungary and so on, you'd go from one side to the other and you'd see prosperity versus misery, practically. Nobody was wanting to go from west to east. And they had to build a goddamn wall to stop the people from going from east to west. What can you

say? And this was both on the ground of political freedom, social freedom, and economic prosperity. I don't think there's any doubt.

05-00:56:07

Burnett: Right, right.

05-00:56:12

Harberger: I went to Russia nearly a dozen times between '00 and '04. They had a huge problem in Russia in that in the Soviet era the motto was to build big and they built these plants with 25,000 and 50,000 employees and so on. They emulated the River Rouge and used that word even.

05-00:56:53

Burnett: Fordism. Yeah, yeah.

05-00:56:55

Harberger: And so you had whole towns that were making only blue jeans and another whole town making only shoes. And then with the opening of the economy they were exposed to world prices and half of these entities were incapable of meeting world prices. But you couldn't shut them down because it was the whole employment of a whole town. So they evolved what they called a barter system, which wasn't a barter system. But what it was, was that these plants stayed open but didn't pay bills. They didn't pay their taxes. They didn't pay their suppliers. Sometimes they didn't pay their workers or their executives. They did non-payment enough in order to keep chugging along.

05-00:58:04

Burnett: Like a zombie factory.

05-00:58:06

Harberger: Yeah. But you could see what a terrible contrast between that and what was going on in China, for example, which was making its transition from communism at the time to a more genuine market system with smaller factories and more competition.

05-00:58:34

Burnett: We're going to talk in more detail about the Soviet and the Russian case, post-Soviet case later. You talk so much in your "advice literature" about timing and about sequencing and that you need to make sure that things are done very gradually and carefully most of the time. Is that a key to creating special economic zones, if you're talking about reorienting an entire economy, is that an important dimension to your thinking?

05-00:59:21

Harberger: Well, I think basically yes. If you're moving from a huge span of import tariffs, say zero to 400 percent, and you were going to get that down to something, the way to go is to, one way or another, narrow the bands. I have, I think in one or more papers, talked about a radial reduction in distortions which is sort of proportionately squeezing everything. As you go to a target you go a tenth of the distance and then two-tenths, then three-tenths, and then

finally you get to the target after ten steps or five or whatever. There will be times when you want to go one fell swoop, but they are not the rule, they're more the exception.

05-01:00:49

Burnett:

Right, right. You also talk about in the crisis moments where it's important to act quickly and there are these moments of opportunity, especially in a democratic society, when the system has been shown to be bankrupt or unworkable or unsustainable. That's the moment when you can get buy-in.

05-01:01:14

Harberger:

That you have to do things and do things that you will not be able to do at other times.

05-01:01:20

Burnett:

Right, right. I think that's maybe what has been misinterpreted. I think Naomi Klein jumped on that, "disaster capitalism" is her phrase. And the portrait of it is —just incidentally, she puts you in a fairly good light, so it's not—
[laughter]

05-01:01:45

Harberger:

Me?

05-01:01:45

Burnett:

Yes, yes. I think describing Milton Friedman's vision for this kind of work, this notion that you couldn't get away with this in a democratic society, nobody would vote for it, therefore it's an underhanded sneaky manipulation of people when they're at their most vulnerable. But if you turn the perspective a slightly different way, the opportunity for reform is *after* a set of policies have run their course and many people have gotten really fed up with them.

05-01:02:35

Harberger:

Yeah. Well, I have always said that the things that were done in Chile, when they were done, the ethos, the way of thinking of Latin America at that time was still so ECLA-oriented that I don't think those measures would have passed in a democratic government at that time. But when democratic governments around the world started copying them, you can't say the measures are anti-democratic. [laughter]

05-01:03:20

Burnett:

Well, to return to El Salvador, shortly it's Cristiani who, I think, co-founded FUSADES, actually, Cristiani's named president and by 1992 I think they have a value-added tax, they've got tax reform and these kinds of things. And during the 1980s it was a mono-export economy. So over half their exports were coffee, and that's the existing system. And today coffee is a smaller export than t-shirts, one industry, and there's a whole bunch of other things that El Salvador is exporting. So there is this evidence that, at least—it's not to say that inequality has been solved and that poverty has been solved. But at

least there is economic diversification in that country as one measure of how it's doing. So the good economics, in your view, if it has a chance to roll out, people can get behind it at a certain point, but it needs that kind of opportunity to work itself out.

05-01:04:42

Harberger: Yes.

05-01:04:42

Burnett: Okay. Well, let's maybe take a break. So before we get out of the seventies entirely, you've mentioned the Mont Pelerin Society and the way in which some of the Mont Pelerin folks were thinking of things differently from your group. But you got some exposure to the Mont Pelerin Society by attending a couple of those conferences.

05-01:05:15

Harberger: Yes. Well, I was invited any number of times, maybe four or five times, as a non-member to the Mont Pelerin Society and they knew I was a sort of free-market person and kind of gravitating to their way of thinking. They would invite me on this or that topic. I never joined on my own and I ultimately joined when Gary Becker was president and he called me up and kind of twisted my arm to the point where I couldn't say no. [laughter] So I've been a member ever since.

05-01:06:03

Burnett: A reluctant member. [laughter]

05-01:06:03

Harberger: And I am a somewhat reluctant member because I'm not as doctrinaire as those guys. I do look at economics in a more instrumental way rather than an ideological way. That sometimes gets me into trouble there. But I try to sort of weave my subtle moderate visions into my speeches and see if I can have some minor impact. But I had a speech in Lima just now in, what was it, late August, early September, and I got invited to another speech in 2017 in Seoul. So we shall see what happens, see if the new gospel will take hold. [laughter]

05-01:07:19

Burnett: Well, what was your first encounter like? They struck you as doctrinaire? What was the feeling?

05-01:07:25

Harberger: We've talked about the Austrians versus the Chicago people, okay, the Chicago people being more scientific-oriented, more real-world observation-oriented and the Austrians being more philosophical, more, I call it, religious in terms of the way they derive from first principles all that they do. Well, on top of them, in the Mont Pelerin, thank God less so today than at the beginning, you had a whole clique of gold bugs that would be getting up and making half-hour speeches about the beauties of the gold standard and why it

was always wrong to go off the gold standard and how we have to go back. And that just drove everybody nuts, Friedman and me in particular. [laughter]

05-01:08:33

Burnett:

So it was a mix of folks who were attached to a very broad-church idea of liberalism, that there must be increasing political liberty that's tied to economic liberty, but—

05-01:08:47

Harberger:

Yeah. Well, let's say there was a big tent with a bunch of very narrow churches inside. [laughter]

05-01:08:57

Burnett:

I think that may be the most accurate representation yet of the Mont Pelerin Society. I think we'll have to make a quotable quote out of that. [laughter] That may precipitate a change, if nothing else does. One of the things that was helpful in preparation for these conversations was an edited volume that came out in '84.¹ Off-camera we were just talking and you told me this was stimulated by a conference that took place in '83. Can you talk a little bit about how that came about and why that book ended up being fairly important?

05-01:09:52

Harberger:

Yeah. Well, this conference was sponsored by the Institute for Contemporary Studies out of San Francisco. And I was asked to set this up and I did. And I created a conference with most of the economists in the area of practical economic growth policy that I really respect and so I think we had Anne Krueger and we had Malcolm Gillis and we had Paco Gil and many others. They were dealing with real-world cases and showing how good economics led to successful results in such cases. Sometimes there were contrasts, like between Ghana and Nigeria or something, neighboring countries where one was doing well and one was doing not so well.

But anyway, the book came out, *World Economic Growth*, and had a fairly good reception. It didn't get *New York Times* bestseller list or anything like that.

05-01:11:26

Burnett:

It's not that kind of book, no.

05-01:11:29

Harberger:

But what happened was the guys at the Center for Contemporary Studies were ecstatic about this and they wanted to continue it. Out of it therefore grew the International Center for Economic Growth.

05-01:11:54

Burnett:

And where is that situated? What institution?

¹ Arnold C. Harberger, ed. *World Economic Growth*, San Francisco: ICS Press, 1984.

05-01:11:56

Harberger:

Well, it was situated and had its headquarters in San Francisco. Nicolás Ardito Barletta, the former president of Panama, my former boss in all my workings in Panama for fifteen years, former vice president of the World Bank, he was the head and Rolf Luders, of all people, was his deputy. And these are both stalwarts in every sense of the word, members of the army. And they did just a wonderful job of assembling think tanks all over the developing world. And these think tanks would be partners in this International Center for Economic Growth. And they built up a series of monographs written by “our people” and they were very good background reading for anybody who was going to try to do policy reform in a developing country. Probably a better shelf of books than you would get out of either the World Bank or the IMF, covering more territory— not where one book is super popular and then the next book is super technical and all of that—these were all on a level where the prospective ministers who were innocent right now and needed help, they could derive genuine benefit from it. So that shelf of books went around.

I remember we had two wonderful conferences in India, one in 1993 and another in 1996 when ICEG started a joint research project with some Indian entity. And so we had these conferences and we had the top people from government, Manmohan Singh and Chidambaram were at these sessions. I was just thrilled by the reach of this thing which I had nothing to do with, but Nick and Rolf certainly did. ICEG received its money from AID and carried on for about ten years.

And then we had the usual, ATIE, I don’t know if we have talked about or—

05-01:15:21

Burnett:

No, we haven’t really talked about it.

05-01:15:25

Harberger:

Okay. Well, anyway, ATIE and ICEG were there over the nineties and were doing a wonderful job and had no enemies. But neither did they have any congressmen pushing for the money to be used for them. And at the end of the nineties you know that there was a big budget-balancing story. Well, something had to go and that’s the way they reached their demise.

05-01:15:59

Burnett:

Right, right. I guess that can be the fate of something that’s not overtly political, a think tank that’s committed to this or that specifically.

05-01:16:09

Harberger:

Yeah. Just good economics.

05-01:16:09

Burnett:

Yeah, yeah. That doesn’t necessarily—

05-01:16:13

Harberger:

Has no lobbyists for it and had no congressmen for it. What can you do?

05-01:16:17

Burnett:

The Institute for Common Sense, that's not attractive to people. We're getting a little bit ahead of ourselves but there was this nice outcome from this edited volume that seeded a lot of good opportunities for people to publish and circulate these reports. Did you ever get feedback from some of the policy people that they had read these monographs and they found them useful?

05-01:16:58

Harberger:

Well, they did. I was not at the center of this. Nick and Rolf were at the center. But they had a lot of interaction with policy people.

05-01:17:08

Burnett:

Right, right. Pulling ourselves a little bit out of the eighties but I think it's germane to what we were talking about earlier. There's a 1992 World Bank report, and you write some commentary on it and I think an article. In a sense it's kind of an evaluation, an assessment of World Bank policy over the seventies and into the period of structural adjustment and there's clearly a consciousness, an awareness that there's criticism. And so it got me thinking when you were talking about the ICEG's focus on good economics and work that was maybe better than some of the World Bank reports that were coming out. The World Bank and IMF and I guess USAID, too, were under some pressure to deal with the perception, really ratcheting up in the early seventies, that a focus on growth alone was not sufficient for development. So you have the [Hollis] Chenery *Growth with Redistribution* in '74 and all the way up to any number of World Bank reports about development and poverty. Is that a significant part of the policy landscape that begins to change? And before you answer that, I'm wondering whether your policy expertise is more IBRD-focused? That is, it's for more of the middle-income countries that have a certain level of development. There's another side of development that's for countries that have below a certain per capita income. So is that something that you were quite aware of or is it something outside of your middle-income orientation during that earlier period, at least?

05-01:19:30

Harberger:

Well, that's interesting. That's interesting. Let me start in the middle of the eighties, where I was named a pioneer in development by the World Bank. For this I had to write a paper, and I did, on project evaluation. I can put that out today and it's not missing much. It goes in considerable depth and considerable sophistication and all of that. It tells the methodology, the underlying deep methodology. Now, I may have mentioned before, but in the late sixties we had the Little-Mirrlees book, we had the Squire and van der Tak book. We had the UNIDO guidelines book. And all of these had their quirks and we had no quirks.

05-01:21:04

Burnett:

Fads, I guess. Yeah.

05-01:21:06

Harberger:

We stayed right down the track and we were not trying to promote our originality. We were trying to promote good economics. Period. And ours has survived and the others have sort of melted by the wayside. And I'm very proud of that, that we, by not being egotistical, ended up having a stronger impact on the evolution of cost-benefit analysis.

05-01:21:44

Burnett:

Well, it's also true that you have done some consulting in that time period, I think at the request of government agencies and so on. You consulted for Haiti in 1986, for example. So that, obviously, is one of the poorest countries in the hemisphere to this day. Because institutionally, IBRD handles countries above a certain per capita income. At least it did. It was like \$730 a year per capita income and then below that it's the IDA that handles. That's what I read. I don't know if that's right.

05-01:22:24

Harberger:

Well, that could be. Yeah, that's just part of IBRD.

05-01:22:28

Burnett:

Right, okay. But it's separate. I wanted to ask you about, and perhaps you've already answered it by the answer you just gave. But what is special about the work for very poor countries or is it fundamentally what you have to say in terms of—

05-01:22:56

Harberger:

It's not very poor really. Very poor can be India and very poor could have been China. But very poor is also Haiti and Honduras, yeah.

05-01:23:10

Burnett:

Malawi, yeah.

05-01:23:12

Harberger:

The little ones have GDPs that are far smaller than General Motors. General Motors is run in an autocratic manner. So you can imagine that with ignorant peasants and difficulties with the soil and difficulties with the water and so on, you get a bunch of technocrats up on top. If they make edicts, "God damn it, you're going to do this, you're going to do that, you're going to do that," there's a good chance that some of them are going to be right and it's going to help them out. And the idea that you're going to have those peasants being so totally educated step-by-step so by year five they're like mini-agricultural agronomists or something. That might not be really accurate. I have come to realize that sometimes, and my experience in Ethiopia was a good example of this. The minister in Ethiopia was goddamned interfering all the time. But they still had 6 percent growth and who was I to say something was wrong? I chalked it up to the fact that the country was small and its agriculture was simple enough and the level of education of the peasantry was low enough that getting reasonable advice by way of orders from the top was able to propel them forward.

05-01:25:18

Burnett:

Right, right. I was going to bring this up in a later session but the way in which even good economics is part of a larger social and political compact, right. So in order for any of this to work there has to be trust. There has to be buy-in. And in the case of peasants, in some cases they might be ignorant; in some cases they might be all too savvy, knowing that the interests of the guy on the top is not necessarily aligned with theirs. And so they might have developed all kinds of strategies to sort of get around whatever edict is coming from on high. And is that kind of a huge problem when you're dealing with any country, I suppose.

05-01:26:14

Harberger:

Well, we're on rough ground here, I think. Subliminal in what you're talking about is a stretching of the income distribution over recent years. Part of the problem there is that this stretching has come from forces that are not the evil doings of these guys at the top so much as the transfer of comparative advantage in manufacturing to the Far East, bringing great benefit to poor people all over the world who are always consumers of cheap everything. Sherwin Rosen, who was an old colleague at Chicago, wrote about the compensation of sports stars and other stars. And it turns out that as the market stretches, the stars who become stars of the Middle Atlantic instead of New Jersey and then stars of the east and stars of eastern United States and stars of the US and stars of North America, stars of the world. At each step, that compensation of the very best keeps going up. And that has an element of reverberation in the compensation of executives in these big firms that are ultimately world corporations. They're not US and UK, et cetera, corporations. So if you understand that and you say, "Well, how can we stop it?" there is not typically an easy way to stop it. And you certainly don't want to screw up the whole system, which has brought a greater exodus from poverty in the last twenty-five years than in any prior twenty-five years in the history of the world. What in the world do you want to do about that? I don't think that there are easy solutions to that type of problem. And at the other side you have the culture of dependency being created. We had the culture of dependency with aid-dependent children, remember, when—

05-01:29:28

Burnett:

AFDC, yeah.

05-01:29:29

Harberger:

When the women were almost paid not to work in order to take care and then in the Clinton Administration they got them to go to work and that was in some sense better. The new scandal, I think, is disability. I'm disabled but I never received a penny of disability of any kind. But I know a hell of a lot of people who are receiving disability for fake back injuries and there's a whole goddamned industry of how do you pretend to have a back injury that will get you one of those disability payments and stuff. That is so much the opposite of Martin Luther King that it kills me. It drives people in the opposite direction from building their strength and building their character and all of

that. I think the issues of distribution are complex and they're very badly dealt with. Things about women. Women get 77 percent of what men get. But that's not true job-by-job. Basically, mostly, job-by-job the relation is quite close. But what happens is the men have jobs which the women don't have. Now, some of those jobs are executive jobs and there's a glass ceiling and you've got a problem of some kind there. But some of those jobs are coal miners and bush airline pilots and goodness knows what, where it makes sense that there would be not such a heavy infiltration of women.

Anyway, when you search for propositions that will help counter the stretching of the income distribution, they're relatively few and far between. We have things in our laws that certainly have been scandals forever, like carried interest. Did I talk about carried interest ever?

05-01:32:29

Burnett:

I don't think so.

05-01:32:31

Harberger:

Okay. Carried interest is when people who run mutual funds are, by some twist that was artificially inserted into the law, are allowed to act as if all of their earnings are long-term capital gains. So they get taxed at a super-favorable rate when what they should be taxed at their ordinary income tax rate. That's how they make their ordinary income, that's what is their ordinary income. It should be taxed as their ordinary income. Well, that's a scandal. Our sugar policy, which protects sugar interests that are a teeny, teeny fraction of the population. I don't know how they managed to keep those laws with such a teeny fraction and small area involved. But there we are. We have this crazy sugar policy and it's our consumers who pay the price. Some big sugar interests take in a lot of dough. So these are things to correct but they're not going to modify the big story of the stretching of the income distribution. That's the thing.

05-01:33:50

Burnett:

Well, I think what I was getting at is offering a possible explanation for why the ICEG stuff was so important. This is something that Robert E. Wood was writing about, is that the World Bank ended up really going into a lot of these areas. The question of very poor communities that are kind of outside the market or on the margins of the market and how you can pull them into the market or how you can serve them better, health indicators, basic needs, the whole basic-needs literature from the seventies on through. And it goes by different names, as you well know. It evolves. But perhaps the ICEG material was important precisely because it addressed that question of what you can do feasibly with the structures that you have.

The World Bank Report that you participated in with a number of the key figures that regularly pop up as part of your group, they dealt with some of the criticisms. So there's an article about—I've got it here. They did a whole bunch of analyses of the effects of structural adjustment on the very poor. And

one of the conclusions that they drew was that some of the labor mobility reforms affected mostly people in the wage-earning sector. It's part of actually the middle class of these countries. The very poor and the lower middle class typically are self-employed. And I'll get this on camera, the name of the World Bank Report, "Adjustment Lending Revisited: Policies to Restore Growth," Vittorio Corbo and Stanley Fischer. So it's almost a point-by-point response to the criticisms of structural adjustment.

And one of the things that you wrote in a brief commentary after one of the essays, I think one of the essays by John Williamson, you wrote, "The World Bank is not a lending institution. The World Bank—"

05-01:36:39

Harberger:

Is a teaching institution.

05-01:36:40

Burnett:

It's a teaching institution. So can you talk about that a little bit?

05-01:36:45

Harberger:

Well, I feel that both the Fund and the Bank have been great institutions. Not modestly great but really great. And I think that some of their absolutely biggest contributions have been through people who have been on their staffs and maybe had ten years' experience, 15 years' experience, going on missions all over the world, different kinds of countries, different environments, different legal things, and then they go back to their country as a minister or as a president of the central bank. They carry an amount of human capital with them that, especially the small and poor countries, practically never existed in those countries. And it's just tremendous that they can bring that expertise and, more or less, even as the World Bank and the IMF are continuing to help in those countries, that is maybe more important because they have actual missions there and they're doing this daily and so on. But to have somebody there in the top role that understands this stuff [laughter] is very welcome. I think both of those institutions have been a pure blessing to the world.

05-01:38:31

Burnett:

You had a section where you comment on one of the articles, which is called "Designing and Implementing Adjustment Programs." And John Williamson is the economist who wrote a 1990 paper where he coins the term "Washington Consensus," with a ten-point set of criteria. And so you write, "John Williamson is fond of talking about the Washington Consensus. I like to think of it as an emerging professional consensus." Could you talk about why that distinction is important to you?

05-01:39:13

Harberger:

Well, because the enemy says, "These things are being imposed on us by technocrats in Washington." Okay. Well, it's harder for them to say, "By the worldwide economics profession." [laughter]

05-01:39:38

Burnett:

Williamson talks about it. His original essay he talks about the fact that Washington is both a political place—he's talking about the political center of the western world but he's also primarily talking about the international financial institutions.

05-01:39:57

Harberger:

I believe that my introduction to the *World Economic Growth* book may have actually antedated Williams's Washington Consensus. And if it did not I was unaware of it and he was unaware of me when he wrote his ten. And I had thirteen lessons. And if you look at my thirteen and his ten, the degree of overlap is like ninety or ninety-five percent, that we are talking the same thing. I drew mine from the experiences that were being related in the *World Economic Growth* and he drew his from a completely different original set of stimuli. But I think that's good economics at work.

05-01:41:01

Burnett:

Well, I can't remember the citation right now but one author, at least, has named you as one of the most important intellectual contributors to the foundation of the Washington consensus, not directly influencing John Williamson but setting up the intellectual foundations and the culture, right, amongst the international financial institutions. It's you and a network, clearly.

One of the things that you wrote about in this piece, which was interesting, is about the changing nature of loans. So the Bank and the Fund are changing obviously from the sixties through the eighties. One of the ways that you described it, has to do with the recovery of revenue in order to pay back the loan. That's one of the things that's changed. I'm not sure if there's a direct quotation. But basically, in the old days the World Bank would lend for particular large projects, often in the electricity sector, giant hydroelectric dams and so forth, which would generate a kind of permanent income stream out of which the state could pay back the loan. Now, with projects like structural adjustment loans, SALs, or SECALs, sector adjustment loans, the benefits are diffused throughout the economy and not recovered by the treasury. So is that project evaluation at work in thinking about how the Fund and how the World Bank are doing this business? Is this your interest in taxation?

05-1:43:14

Harberger:

Well, no. I would say that observation is just that. I have nothing against structural adjustment loans. But one of the aspects of structural adjustment loans is they're not throwing up the wherewithal to pay them back and that makes them different from what came before. And that then when you have a structural adjustment loan you have to think about how and when are we going to get the wherewithal to pay these loans back. And that can be a lot of pressure. Looking at our own handling of our own budget, I become more of a grumpy old man every day.

05-01:44:38

Burnett:

Are you talking about in the United States or in the West in general?

05-01:44:41

Harberger:

Well, in the United States and other countries. Look at Japan. It's far worse than the United States in terms of its accumulated debt. I don't know how the hell countries are going to get out of that problem. People don't realize how well-off they are. Everybody thinks of himself as a victim of some kind. Unless I have a ninety-inch TV set I am being discriminated against or something. Unless I have hundred-dollar sneakers I am not worthy of the playground. All that kind of stuff. Look at the people of Africa and the Middle East and so on and the miseries that they're going through. Most people in advanced countries have no inkling of comparing themselves to that and realizing how lucky they are and what great opportunities they have compared with these other people. Everybody in the rest of the world would give their eyeteeth to come to the United States and be—

05-01:46:17

Burnett:

And they do.

05-01:46:17

Harberger:

—in. And the ones that are here are badmouthing all the time. It's sad to me.

05-01:46:29

Burnett:

Well, I was going to save this question for the last session but perhaps it's worth asking twice, because I think on two different days you could give two different, equally valid answers. Let's say that the US Agency for International Development, its mandate has been reoriented and you've been hired by them to consult for what needs to be done for the United States to develop its resources in a more responsible fashion.

05-01:47:18

Harberger:

Well, at that level I would say, first of all, that I am proud the United States has managed its exit from the Great Recession as well as it has and that Bernanke and Paulson and Geithner in particular are heroes of mine for having done that as well as they did. I think we are going too far back toward a culture of dependency in the way we organize these institutions and I think that we should listen more to Martin Luther King than we do, that I would love to see all of our more deprived people concentrating on the content of their character as the driving force of their life. And I think it has gone the other way. Illegitimate births among black girls were like 18 percent in the sixties and are now 75 percent. That's terrible. And the culture that emerges from that, where the kids grow up with no fathers and where the gang becomes the home. I'm not a sociologist. I don't know how to deal with that really. But I think that kind of culture looks down upon the person who studies hard. They probably bully him and beat him up on his way home from school, make fun of him. That's no way to generate social mobility. We have to try to somehow recreate older times. The military has been a wonderful corrective in these respects, I think, that those who come from lower ranks of

society and pass through the military, they don't all become generals or anything like that, but some do and some become colonels and some become majors and goodness knows what, and staff sergeants and master sergeants. And when they get out they lead disciplined and successful lives and get good jobs. And what's wrong with trying to sort of emphasize that kind of a track instead of thinking—it troubles me, this conflict we have between the police and the black community these days. The problem is that the ones in these gangs have guns. They have a lot more guns than other people. If you go to Scarsdale, New York and you find a bunch of kids playing football on a field you're not going to find guns. You go to South Central and you find a bunch of people playing basketball, you might find guns. And that the police should be aware that these guns are not to be seen. But they think about that and that is a part of the cause of this issue of shooting when they shouldn't be shooting. Because they have that tenseness. It's nice telling me, "Well, don't." If somebody's pulling out something that looks like a gun, you don't have many minutes—

05-01:53:02

Burnett:

Or seconds.

05-01:53:03

Harberger:

—to make up your mind. So we have much deeper problems there, and I honestly don't know how to turn around the civilization. In the old days, in Chicago, we had a ghetto and we had restrictive covenants right around. Cottage Grove was this limit, so on that side was black and on this side was white. And if you were white you couldn't rent to a black person and you couldn't sell to a black person. That was that. When that was true that black community was better behaved. Why? Because you had lawyers, you had doctors, you had nurses. Everybody was there, and they had churches that were big centers of social life. And you didn't have high levels of illegitimacy, et cetera, et cetera, et cetera. Then came the Supreme Court decision in the late 1940s and you had a pouring out from this ghetto of whom? The doctors, the lawyers, the nurses, the engineers. It was drained practically of the people who were the key pillars of a functioning society. This left a more chaotic situation behind and our laws with the aid to dependent children and all of that helped to add to that. We just got into one set of troubles after the other. Question is how do you change all of this? You can't put history in reverse gear. And it is a real damn problem. I may sound starry-eyed on this but I certainly would want to think seriously about a period of one or two years of national service for everybody. I went through my three years in the Army. It didn't do me any harm. I got to see people of very different backgrounds from the ones out of which I came. I got very much to broaden my perspective in so many ways. What's his name from AEI? Charles. He writes about society all the time.

05-01:56:49

Burnett:

Charles Murray?

05-01:56:50

Harberger:

Yeah. That he, among many others, have pointed out that our society has become self-segregating. That we are self-segregating in a much deeper way than just black and white or black, white, Hispanic, or something like that. No, we have these gated communities like Bell Canyon, where I live. Who's in Bell Canyon? Well, people of a similar income level, people with similar thoughts, people with similar prejudices about politics, society, and other things. And if what we do in Bell Canyon is comingle with each other, which, of course, I don't, but to the extent that people in those communities do, which they do do a lot, they just reinforce their prejudices and their ideas and so on. We can be a conglomerate of these narrow enclaves where the enclaves are super homogeneous within themselves and we don't have a mechanism that throws humanity against humanity in the way that the World War II draft did, certainly. And you want a big thought? There is one. [laughter]

05-01:58:32

Burnett:

That is one. Some of these effects, you can talk about desegregation as being a legal breaking down of hitherto isolated communities. But globalization, too, is a breaking down of hitherto protected economies. But they're also cultures.

05-01:59:02

Harberger:

Breaks down old cultures. The British are very annoyed. Many British are very annoyed with all the Pakistanis and the Indians that have come to take over London and other big cities.

05-01:59:15

Burnett:

Because you were talking about what can the United States do to recover this cementing of what is in essence local community, right? That that's the engine of—

05-01:59:35

Harberger:

I don't know. See, I don't think that the local will do it. But if we were to have this kind of national service where people go for two years and they're doing all kinds of things, from Peace Corps to helping in hospitals to doing this and that, to living in barracks or something like barracks, just schmoozing day-by-day with people from other backgrounds and with strong discipline on top to prevent bullying and things like that to the degree possible. People come out of that wiser and stronger.

05-01:00:28

Burnett:

Have you looked into the economics of national service?

05-02:00:31

Harberger:

No.

05-02:00:33

Burnett:

That could be a new growth area to look at, [laughter] to think about a range of national service, from military to social to health. That this would be something that could inspire people to develop, as you say, character. Okay. Well, let's pick up in the afternoon.

05-02:00:53

Harberger: Excellent. Okay.

Session 5B, Afternoon

05-02:00:58

Burnett: This is Paul Burnett interviewing Arnold Harberger for the Economists Oral History Project and this is our afternoon session of the fifth session. And we're here in Los Angeles, California and this is March 1, 2016. So one of the things we haven't talked about in a while is your ongoing engagement with the University of Chicago and you are still a professor there and you're teaching graduate students. Can you talk a little bit about some of the students you had in the seventies and into the eighties that you were supervising?

05-02:01:50

Harberger: Well, I'd say that one rather big change happened. You see, I had the public finance workshop and we had this wonderful, wonderful huge group at the beginning in '53 to '60, which somehow led to the book *The Demand for Durable Goods*. And then we got a grant from Brookings in the sixties and we had another great group which included Bob Lucas and that led to a book called the *Taxation of Income from Capital*, which came out in the late sixties. And I would say that, broadly speaking, the public finance-oriented emphasis almost ended there. I kept writing in public finance and every now and then because I would have a thesis. My first UCLA PhD was Daniel Artana and he is one of a very small coterie having great mastery of Harberger tax economics. Another is Glenn Jenkins, who is a world figure in benefit-cost analysis. I was the first president of the Society for Benefit Cost Analysis when it was formed and Glenn was the third. The second was Dick Zerbe, who was the entrepreneur who did the forming. So of the true practitioners, Glenn and I were the first two in that and he was a PhD from the seventies. And then there's Bill Dougan, who is the guy that is my boss, as it were, when I go to Clemson. He is the *eminence grise* of the Clemson department, distinguished professor and all of that, having been chairman for many years. And he has absorbed Harberger public finance economics, both sides, just incredibly well. Incredibly well. But I can't carry on that list very far of people who kind of got it all. Dan Wisecarver, who is in El Salvador at this moment, is another, certainly on the public finance side. But in the main my dissertations in this subsequent period were more oriented to the developing country people and more oriented to developing country problems. Real exchange rate analysis was coming up, oh, at least a third of the time, so to speak, in one way or another. And I had Mexican students, Chilean students, Argentine students, Chinese students, all involved in real exchange rate economics in one form or another. Ecuadorans. The Chicago people got their stuff earlier and so when they got back to their countries they were more suitable to become ministers and things like that, just in terms of age and experience. The UCLA people have taken longer to mature in that sense because their training was really mostly starting in the late eighties and nineties. Yet I'm very proud of Laura Alfaro. Laura Alfaro is a full professor

at Harvard Business School and was taken away from there by Costa Rica for her to be minister of planning in Costa Rica for a period. Another person contemporaneous with her is Edgar Robles, who was vice minister of finance for a while, and then turned out to be the head of their corresponding thing to the SEC for many years. And we have one member, Sebastian Claro, who is on the board of governors of the central bank in Chile. And in the last presidency of Sebastián Piñera we had about five ministers or equivalent of my former students in that government. We had a big luncheon one time with the ministers from the UCLA mafia, not from the Chicago mafia. That was so nice.

05-02:08:14

Burnett: Well, yeah. People have different tallies but I think one set of statistics that comes up is that you have trained a dozen central bank presidents.

05-02:08:27

Harberger: Well, it's about fifteen by now.

05-02:08:28

Burnett: About fifteen. Okay.

05-02:08:31

Harberger: Yeah, and about forty-five ministers.

05-02:08:33

Burnett: And about forty-five ministers, finance ministers, and so on. Or various government departments, not just finance. And that's in Latin America but also all over the world.

05-02:08:45

Harberger: Yeah, India, Israel, and other places.

05-02:08:50

Burnett: Yeah, yeah. So there's an academic legacy in terms of figures like Jenkins, who end up being heavy hitters in the academy and there are others who are doing things in their countries.

05-02:09:03

Harberger: Exactly. I'm as much proud of the ones that have gotten their hands dirty in the real world.

05-02:09:11

Burnett: Well, I think, yeah, that would be the Harberger approach I would think, right?

05-02:09:15

Harberger: Yeah, yeah.

05-02:09:20

Burnett: So you've done a tremendous amount of work teaching and conducting research and getting those large workshop programs, sustaining funding

throughout their life spans. But other opportunities arise, let's say. So in the early 1980s what happens career-wise for you in terms of the academy?

05-02:09:54

Harberger:

I don't know where you're going with that. I have the transition to UCLA, which was very simple. We were at the meetings in '81 in Washington, at the end of '81 or beginning of '82. I forget whether it was December or January. And my dear friend Gregg Lewis was being honored in the Chicago party and I was taking part in that. And Gregg at age sixty had decided to move to Duke. So I'm in there with that Lewis party and who comes in but Axel Leijohufvud, who is the chairman at UCLA, and says, "Can you come over next door to the UCLA party?" I say, "Sure." And he says, "Well, we want to try to see if you might be interested in making a transfer to UCLA." And I said, "Well, I've always been completely happy at Chicago and I don't have any reason not to remain happy at Chicago and so on. They've always treated me well and I've always felt good there. But I'm getting old, too. And it was eighty-two; I would have been 58. And I said, "I just came out of the thing with Gregg and Gregg at about sixty decided to move to Duke, which is a much more welcoming environment for old people, just walking around the street, not otherwise. He had been mugged in front of Rockefeller Chapel. Gregg. And we had had our house entered three or four times by kids and stuff and no big deal. But I told you I think all the bicycles the kids ever owned were stolen. So the idea of me getting to be in my eighties and nineties in that kind of an environment with snow in the winter and all that kind of stuff, why? And UCLA was a pleasant place. And I had turned down offers at Princeton first. Part of it was the Latino aspect. I always wanted to try to reconstitute my Latino story wherever I went. So in Princeton they said they would give me like 20 percent of the admitting class I could admit on my own. Pick my own. And that sounded great. But the admitting class was twenty, so that was four that I could pick. And that didn't make too much sense to me. Then in Harvard they were again feeling quite generous. They had a thing called the Mason Fellows, which were mid-career people. It was a big fat grant that brought mid-career people to Harvard for a year. And there was always some issue about that because in an unkind way you could say many of them were sort of tourists. They were coming from Czechoslovakia or there or here. But were they really studying hard and getting what was being delivered? There was some question. So anyway, they offered to change that into a regular graduate student thing in the Kennedy Center. And I would be in charge of that program and I could pick. But it wouldn't be Latin American; it would be from all over the world. So that looked pretty good. But then we had this eruption on the Harvard thing. I was being offered to be a director of what was then and now HIID, had previously been the Development Advisory Service. And all the economists, or all but one maybe, I think all the ones in it were for me, but many of the non-economists had the idea that I had horns of one kind or another. And I just decided that it didn't make sense to become an executive of something where your big job for the first couple of years is to prove that you don't have horns. Why, when people where I am know I don't

have horns right away? So between the not-terribly-appetizing idea of the Mason Fellow thing and this business of the horns I had turned Harvard down.

So here comes Axel and I say, “Well, California’s very enticing and so on.” And I must have talked to him about the Latin America thing and all of that. But anyway, what we agreed was that I would start out by just teaching half a course in the spring for a couple of years and so that’s what I did. I taught a course jointly with a younger assistant professor and I did half of it and then that person took over the rest of it. I taught there. Then the second year I did it again. And then the third year I took a leave from Chicago and I did half a year at UCLA as a visiting professor in winter and spring of 1984. By the end of that I signed on and one of the big reasons why I signed on was they had a nice group of Latino students, not too many, but they were all really good. And they had been well selected from top Latin institutions, which we in Chicago knew which ones they were and was part of our own secret of success. We were able to tell the sheep from the goats, as it were. So anyway, when I broached the idea of having a Latin American group in UCLA, they said, “Oh, boy, you’re going to help us get more of them?” They were enthusiastic rather than trying to limit numbers and all that kind of stuff. So that was the final element apart from the weather, and the fact that UCLA was an almost- Chicago department at that time. Many people called it the West Coast branch of Chicago. So all those things made it very easy for me to say yes. The long drag out came because I had about fifteen to twenty PhD committees that I was on in Chicago. If it’s two or three you can carry them on as an act of charity to the student. But you can’t do that with fifteen to twenty while working for somebody else full-time. So we reached the agreement that we’d have this seven-year, six-month/six-month arrangement and that’s what we did in that transition. And that helped me work down the backlog. I didn’t take on any new Chicago committee memberships and gradually, gradually, they worked their way through the mill and got out. And then I became in ’91 full-time at UCLA.

05-02:19:19

Burnett:

So that explains that transition, that you had fifteen to twenty PhDs to finish supervising in that period.

05-02:19:27

Harberger:

Yeah. I wasn’t chairman of all of them.

05-02:19:30

Burnett:

No. But still—

05-02:19:31

Harberger:

UCLA, it’s almost a tradition that the chairman runs the damn thing and the rest kind of are there maybe to keep an eye out that the chairman doesn’t do something terribly gross. Goodness knows what. Rarely do these other members do anything. I, for a long time, insisted when I was a parallel person on a PhD committee that, “Oh, you’re going to take that chapter? I want a

chapter of my own to run.” And that’s more or less the way we did it at Chicago, the members of the committee would split up the supervisory job and take principal responsibility for pieces of the thesis. Anyway, it all worked out extremely well. We had excellent Latin American students from the very beginning. The cohorts that were there during my time of fifty/fifty are still some of the best.

05-02:20:50

Burnett:

In terms of pedagogy and how you wanted to organize the teaching, I imagine there must have been influences from your time at Chicago, the way you approached graduate education.

05-02:21:13

Harberger:

[laughter] Well, my style is different from most, utterly different from most. I want to train people in good economics. That’s what I want to do. So I overload the reading list with my own writings, not because my own writings are so original but that they are pulling together in an organized way, in a consistent way, and they’re conveying a way of thinking about a problem, you see. And if you go sort of splashing around, especially when you’re in a quarter system, you’ve only got eleven weeks, you’ve got to get whatever you want to get across in those eleven weeks. So there was that element and mostly I taught without notes and I carried my courses in my head. And I really liked that idea in the sense that I had been subjected sometimes in my own education to people who read their lectures. And guess what? They rarely changed from year-to-year, or even decade-to-decade. Just dah-dah-dah. And when you’re carrying it in your head you’ve got an automatic evolution, that your head changes from year-to-year. New things enter, old things disappear, old things get modified. And there is a nice consistency, coherency, but evolution that’s taking place in the course without really working hard at it. It just—

05-02:23:29

Burnett:

Happens.

05-02:23:28

Harberger:

—kind of happens. By this time everybody was being overwhelmed with these formal models and things like that. I was telling them how to estimate the externality that a vehicle on the 405—you’re driving on the 405 and let’s say the unimpeded speed of traffic on the 405 is sixty. Call that A. Make it seventy. Seventy is A. And then you’re riding along at forty. Okay. Forty is S, Speed. A minus S, seventy minus forty, that’s thirty. A minus S divided by S is thirty divided by forty. So the externality, the damage that you’re doing—you’re bearing the time cost of going at forty. But the fact that you are there is slowing up everybody else. And if the hour is worth eight dollars, the vehicle hour, eight dollars divided by forty sounds like twenty, right? So that’s twenty cents a mile. So that’s the value of the mile. Now you have to multiply that by A minus S over S. So that’s 75 percent. So fifteen cents a mile is the damage

that you're doing by slowing others down and is the tax that you're supposed to pay if you are to bear the cost you are imposing on others, you see.

There's graphs and all that leading up to this and why it is that adding traffic slows the other guys. That's the source of the externality. How do we value this externality? How do we measure the value of this time? What evidence can we use to do that? And they love this kind of stuff compared with the formulas. And so I always had a good *éclat* with the class, no matter in project evaluation or in taxation or in the macro course, which is the one that they most like, because the stories are more dramatic. They see the real-world debt crisis and the Chinese inflow of capital and the Russian inflation and all of that. They just fall in love with that. So I always had a good time with those guys. Even up to the very end.

05-02:27:38

Burnett:

You've written about teaching, not just about education, economics education, but about wisdom that you have to pass on to new generations of economists. Anne Krueger led a commission on graduate education in the early nineties and produced a report for the American Economic Association.

05-02:28:14

Harberger:

And I cited that certainly in my "Search for Relevance in Economics."

05-02:28:19

Burnett:

Yeah. The surveys of what students want.

05-02:28:24

Harberger:

Yeah, yeah.

05-02:28:26

Burnett:

They noted resoundingly that they wanted more applied work and that resonates with you because that's—

05-02:28:34

Harberger:

Yes, exactly. With me they always got it. [laughter] That's why I didn't have any trouble.

05-02:28:44

Burnett:

Well, you've talked about the sort of metaphors for economics and you've mentioned that it's like practicing medicine.

05-02:29:00

Harberger:

Yeah, in many respects.

05-02:29:02

Burnett:

In many respects. Can you talk about some of the different respects?

05-02:29:05

Harberger:

I think the first and most absolute is that we can't go about making experiments the way physicists and chemists can. They can play with their

business almost any way they please. But when you're dealing with human beings on the one hand or when you're dealing with whole economies on the other hand, you can't just sort of play crazy games to find out what will happen if. So I'd say that's one of the big differences.

But another important element is that in medicine you're dealing with an organism called the human body and that organism, which is your object of investigation, so to speak, has amazing properties of being able to heal itself. And so, too, is the economy. That you go mess up an economy and you say, "Well, you can't have drugs." And what happens? The drugs come anyway. And you're going to put a ceiling price on this or that and guess what? They can't produce it for that ceiling price. But it still appears in a black market. Now, see, these are natural responses of the organism to some invasive force, so to speak. And I think in that element there is a great deal of community between medicine and us. And because of the paucity of very complex situations—you don't have people in a totally controlled environment undergoing this or that or the other thing—each recession is different. Each recovery is different. And you just have to be more alert and more perspicacious and more humble in many ways. I tend to be relatively generous in making judgments about other economists only in the sense that if one professional says, "Well, we're here doing this," and another professional says "We're doing that," I say, "Well, they're both within a reasonable range. That's it." Now, if somebody says he's going to do something way out here, I'll say he's crazy.

05-02:32:15

Burnett:

Well, I guess to extend the analogy further, when biomedicine is dealing with the human body they have built up a body of regularities by studying thousands and thousands and thousands of different bodies. Those bodies are not radically idiosyncratic. They have regularities to them. And so the economics profession has a corpus of regularities. We won't call them laws. But there are regularities in the ways that economies operate.

05-02:32:49

Harberger:

Yes, exactly. I don't know. Did I talk about the effects of a rise in the price of gasoline at any point?

05-02:33:12

Burnett:

I don't think so.

05-02:32:16

Harberger:

Okay. This is kind of interesting methodologically. There are people who are just hunting for a chance to say, well, the law of demand doesn't work and supply and demand is no good, people like Naomi Klein. [laughter] I say, "Well, we've had now several times when the price of gas has doubled. Suppose somebody fits a regression which incorporates this time and this regression says when the price of gas goes up people buy more gas." Well, that violates the law of demand, doesn't it? That isn't so good. Now, should

you just buy into that and say, “Well, because this equation says this, that’s what it is.” And I say, “No, way, that we have many more ways to test this.” Among others there are fifty states in the United States. In all of those fifty states the price of gas had doubled. Now, in how many of those fifty states did the gas consumption go up and how many down? And it would be very few that it went up and a lot that it went down. But we don’t have to stop there. There are 3,000 and some counties in the United States. We can look at those counties and ask, in how many did gas prices go up rather than down? And if we’re not happy with that, how many gas stations do we have? By the time you’re at counties and gas stations you’re working with a chi-squared distribution and with probability levels of one in billions. The tables don’t go far enough to give you the right number of how improbable is this concentration of quantity going up when price goes up. So I keep pushing that kind of observation as a corrective to those who, whenever they see in some flashy thing that they’re doing something that looks counterintuitive they leap to try to think of that as the norm.

05-02:35:51

Burnett:

Thinking of the critiques of structural adjustment or Ha-Joon Chang’s narrative about protectionist economies versus the liberalized economies, his periodization is very cut and dried. It’s the sixties and the seventies versus the eighties. But the success stories he identifies are the ones that you identified as examples of trade liberalizations, the Campos period in Brazil.

05-02:36:27

Harberger:

Of course.

05-02:36:28

Burnett:

Or Korea, which from 1959 is liberalizing—

05-02:36:32

Harberger:

Or Taiwan.

05-02:36:33

Burnett:

Or Taiwan. And so if you stick to a very rigid conception of this is austerity in all of its facets and it has to be absolute, rapid, with absolutely no controls ever, then that doesn’t fit that picture. But if you talk about meaningful liberalization across a wide range of criteria —

05-02:36:54

Harberger:

Exactly. In what direction are you moving? India moves in the direction of freer markets. China moves in the direction of a freer market. Vietnam moves in that direction. Taiwan moves in that direction. Japan. All of them.

05-02:37:10

Burnett:

Right. I think we were talking about students. I want to talk about this tomorrow if I can, about real exchange rate economics and I think it’s very important to you. And you mentioned that students were interested in this in the early seventies. You mentioned the Harry Johnson/Robert Mundell

students, the Chilean students who kind of helped you to think differently about open economy macro. Can you talk about other instances where there's a flow from the students? The questions that students are asking that provoked you to move in a new direction or explore a new topic?

05-02:38:12

Harberger:

Well, not so much. Most of the pushing that I got was from being out in the world and dealing with practical things. I started in electricity economics in India with Nino Andreatta way back in 1961-62. And I worked with Ontario Hydro in Canada. I worked with Commonwealth Edison in Chicago. I worked for the World Bank on a big hydro dam in Honduras, El Cajon Dam in Honduras. I worked on another big hydro dam that didn't happen in the end in Costa Rica, which was the Boruca Dam. And then I worked on another dam in Chile, the Colbun Dam, and I gave lectures, sequences of lectures to each of the two Chilean electricity companies, teaching them electricity economics, which after having a whole career in electricity, their eyes were opened by seeing the big picture of electricity economics, which they kind of had in the back of their heads but didn't see it as a rigorous way of thinking about and analyzing the electricity system. In Mexico, the Comisión Federal de Electricidad, I worked for them many times. And in these projects I learned one hell of a lot about electricity economics. [laughter]

05-02:40:14

Burnett:

Were there problems that at first appear special to electricity economics that ended up inspiring your thinking about other more generalizable problems?

05-02:40:42

Harberger:

I wouldn't say so, though there is a certain thing. You have the idea of peak time surcharges in electricity economics and you can even think of an almost continuously varying peak time surcharge, just depending on how scarce is energy at that time. When it's scarcer it should be more expensive. Well, the connection with that between highway tolling for congestion, like now with the modern stuff where they use these electronic sensors. They can have tolls that vary by the minute according to the density of traffic and so on. And I think in some places they may do. But that isn't always so favorably looked upon because people like to know what they're paying. And if you have too automatized a system they don't know what they're paying. But there is that, certainly.

05-02:41:57

Burnett:

And so during this time talking about you're now fully ensconced at UCLA and you're teaching there but you're also continuing to do a lot of consulting. How is your time divided pretty much at that time? You're teaching a course? A semester?

05-02:42:33

Harberger:

I always taught one course per quarter, both in Chicago and UCLA. And from 1962 I always taught all of my courses six hours a week instead of three, and

that enabled me to be absent for up to half the time without cheating the students. And I never was absent half the time so they always got at least as much, and usually more, than what they paid for. [laughter] And I was free to bounce around. Every now and then some bean counter would say, “How can you have this class six hours a week? Suppose everybody wanted classes six hours a week?” And I said, “How many others have ever asked for it?” Nobody. [laughter]

05-02:43:20

Burnett:

End of conversation. So during this time you’re doing quite a bit of consulting and also setting up more training courses for—again, speaking of real-world people, these are short courses, quite involved courses. So I’m wondering if we can talk a little bit about the Argentine Ministry of Economy.

05-02:43:52

Harberger:

Yeah, the Argentine thing. That’s a good point to start. Okay. Well, Argentina went through one of its worst periods in the late 1980s. They had terrible runaway inflation, hundreds of percent per year, even getting into the thousands. And they had these plans to stop it. They called one the Austral plan. And then Austral number two and then the Primavera Plan and then some other plan. And all these plans would fix the exchange rate and promised they would stabilize now on the basis of the exchange rate. But they didn’t do anything about their budget deficit. They didn’t do anything about the hemorrhage of money that was coming out. And all these plans lasted five, six weeks, eight weeks, maybe ten weeks, and they would break down. So Cavallo got in as minister and the first thing he said was, “We’ve got to stop this inflation more directly.” And so he conceived the idea of having another plan to stabilize the currency. But how can you do that when you’ve had four or five failed plans of the same ilk? And he said, “Well, we have to have a law from Congress.” So that’s where they got the convertibility law, that the Austral would be one-to-one with the dollar. And that was the law from Congress, and it could only be repealed by Congress. And that led to a greater amount of confidence in this. And he did some necessary fiscal adjustment. But as things work in the real world, not all the fiscal adjustment was necessary because with the revival of this degree of confidence, Argentines who had been pouring their money overseas started to bring it back and foreigners started to buy up entities in Argentina, also bringing money back. So this inflow of capital justified a real exchange rate which otherwise would not have been viable. But it so happened they got about two years’ worth of inflow of capital, making life easy for them. But then that inflow of capital tailed off. It didn’t reverse. Didn’t go from being an inflow to an exodus but just as in the cases we talked about with the debt crisis, the mere stoppage of a big flow can require a big real exchange rate adjustment. And so that’s what happened in Argentina. And starting around ’94 they had on the order of 15 percent unemployment, which continued all the way through to the end of the century and had its denouement in the crisis of 2001, 2002, where things exploded and the [Nestor] Kirchner government came in. Well, I was lucky to

have called that situation while it was going on and I was a somewhat lonely voice in that. You can see why, too, when you say the real exchange rate is out of whack—suppose the government says that. People are going to say, “Well, there has to be devaluation.” Well, you don’t want to create an expectation with devaluation if you’re in the government. You’ve got to be quiet about that. There’s a story about this guy from Colombia who was a minister and he came in at a time when they thought there was some problem of possible devaluation. And he named a commission to study things. And it went on for a while. And the commission then reported in secret and the press was interviewing this minister after that. And they asked the minister, “Well, what’s the story about the devaluation?” “Oh, the report said it isn’t necessary now but we’ll have to have one by December.” Once he said that, they had it the next day. [laughter] But that illustrates the dangers that face people in authority when devaluation is something. They have to deny, deny, deny, deny until finally they say, “Well, here it is on the spot.”

05-02:49:18

Burnett:

Right. Well, you also told that other story about the announcement. It was in the Pinochet regime when they announced a devaluation that was—

05-02:49:26

Harberger:

—that was not a devaluation.

05-02:49:27

Burnett:

It was a result of a correction in their actuarial processes. But in Argentina, that’s a long set of crises and I think they’ve only just now retired the last of that debt or the outgoing Kirchner government—

05-02:49:48

Harberger:

That’s a different story. The Kirchner stuff comes later. But anyway, Cavallo was in there and he had been foreign minister for some crazy reason and had been very impressed by the foreign service people. The foreign service people in Argentina had been trained by special courses in universities and only entered the foreign service with an important exam based on these preparatory courses. And he was very disappointed with the top level economics people in the economics ministry. So he asked me first to organize a training program for his so-called “national economists.” “National economist” was a hierarchical level, pretty high. So I made this course with two of my Chilean students. Ernesto Fontaine gave them forty-five hours of micro and Álvaro Donoso gave them forty-five hours of macro and I gave them ninety hours of applied micro and applied macro. And this was all in the course of something a little less than a calendar year and I think it was ’94. Cavallo was very pleased with that. And then after that he said, “Well, now we need a training course for the new entries like they had for the entries into the foreign service.” And I helped to design the program for this course. It was a two-year program, roughly master’s level. And Cavallo, who was a fairly astute politician in addition to a pretty good economist, ended up giving this course to four entities in Buenos Aires: UBA [Universidad de Buenos Aires],

[Universidad Torcuato] di Tella, [Universidad de] San Andres, and [Universidad del] CEMA. So these were the four plausible contenders and he didn't want to have one of them get that and the other three be sniping at him. But it was not economically a very good thing because then the participants were divided into four separate groups and I, after having designed the curriculum, was made the external auditor of this program for as long as it existed, until the end of the century.

And I used to go two, three times a year for a couple of weeks each time to do this auditing. And I'll never forget the first time I went, I got into my hotel room and barely had Anita and I opened our suitcases and sort of relaxed on the bed or something, there was a knock on the door and here are two uniformed guys with bankers boxes full of all of the blue books of all of the courses in all four of the institutions for an entire year. This was my grist for the mill to see how well they were doing. And needless to say, if there is a theorem that emerges out of all of this it is that if some external person wants to learn what's going on in a course tell him to, A, look at the exam questions but, B, look at the answers and look at the grades that they get. By the time you have done that you know a huge amount about what the professor is thinking, what weaknesses and debilities he has conceptually and so on about the course and so on. But it was the most terribly boring work I think I've done in a long time. Anyway—

05-02:54:53

Burnett:

But it was of service to them to have that feedback.

05-02:54:57

Harberger:

What came out of this was a theorem which I have pronounced many times and I have had no serious backflow against it. And that is you take somebody who is a recent PhD and you give him a course in labor economics and what's he going to do? He's going to give the most advanced course that he had in labor economics in his PhD program. Doesn't matter if it's a freshman course, sophomore course, master's level, PhD level, whatever. He's going to be throwing them all that stuff because he's so proud of how advanced he's going to make this thing. And the younger people who were teaching in these courses were all giving MIT courses, Stanford courses, Wisconsin courses, Chicago courses when they should have been thinking about what does an Argentine government economist need to know about this field, you see. So my struggle was all through, from beginning to end, to try to pound into these guys to think in those terms, to think about what the participants will need when they work as government economists. Now, the older people, many of whom had been in government, Osvaldo Schenone was one of ours, he was great. He was a coauthor with Ernesto Fontaine of a book called *Everyday Economics* or something like that. So he was right—feet on the ground, solid, useful. And a couple of guys from UBA, which isn't such a great place but these are people who had some gray hairs on their head and had been around and they were thinking about what their clientele needed. And in spite of their

having been less well-trained than these smart whippersnappers who were coming in from MIT and other top schools, those old guys were really trying to address the skills that people working in government would need. I think the program was something that was worthwhile and definitely should have been continued forever. But it never fully overcame this debility that they were getting more fancy stuff than they needed. But they were also getting a lot of stuff that they did need and it was good for them and they were coming in better than the economists who had been there before.

05-02:57:54

Burnett:

So it was a success in that sense. During this time you're also consulting for governments and helping. I can only assume that there's a relationship between the consulting you're doing and the kinds of writings that you're doing, research writings that you're doing. In the early 1990s and I guess late nineties there's a joint commission on tax reform for the Mexican Ministry of Finance. So in terms of tax reform, in the late eighties and into the nineties, what were some of the lessons that you were learning and what were you trying to achieve through consulting work with the countries on the level of tax reform?

05-02:58:54

Harberger:

Well, I think that in Mexico Paco Gil was a key figure all the way from when he got his PhD in the seventies until when he was minister in the Vicente Fox government in the two thousands. And Pedro Aspe was an MIT product who was a good friend of Paco and myself and he was another key figure in the same vein. And they kept trying to improve Mexico's tax system in this way and that way and the other way. Now, maybe not every time but half-a-dozen times anyway, I was called in to help them do things. Part of what I was doing at this time was on the electricity rate story and working steadily with them. Another part was not taxation but trying to implant in Mexico a system of project evaluation that was some member of the family, guided by what had happened in Chile where they had the best in the world for a developing country. That was a sad story in a sense because Ernesto Fontaine was such a character. He was inimitable. Students loved him. He had an extremely dirty mouth for a professor. He had gone through the Chilean version of Eton and Harrow, these English-type schools where people forever make fun of each other and all of that. So he kept making fun of students. When he came to teach as a visiting professor at UCLA he said, "Oh, yes. You with the slanty eyes," pointing to some Chinese guy. [laughter]

05-03:01:17

Burnett:

Not super politically correct. Yeah.

05-03:01:18

Harberger:

And he got called up for that.

05-03:01:20

Burnett:

I bet. Jeez.

05-03:01:22

Harberger:

But his worst one, I don't know if I told this to you, in class he pointed to a beautiful blond once and he said, "Are you a real blond or are you a taxi? Black below and yellow on top?" [laughter]

05-03:01:44

Burnett:

Oh, dear. Oh, my goodness. Well.

05-03:01:53

Harberger:

But, I mean, they loved it all the time. When he ran this project, of course he had these people going until midnight for six months doing classroom work and then he had them for another six months doing practical project work and he had a big panel at the end reviewing the work of the project people with a month more for them to respond to the comments of the panel. I was always on those panels. It was world class. World class. And we tried to do something like that in Argentina and we tried in Mexico and we tried in some of the Central American countries. Some of them worked pretty well, but there was never an inspiring leader like Ernesto that would just galvanize people to be enthusiastic about this stuff and want deeply to do it. So that was our real problem in Mexico. We had a good team and we had a good program but the leader of the program was sort of an *apagadito*, what do you say? The shades are down, so to speak. Not the spark that Ernesto had. The level of success was contingent in part on that. It was more dull, more bureaucratic, more this, more that. Project evaluation can be tricky because it's so easy for it to turn into a formalism where they have to fill out forms for each project and they fill all the blanks and put a stamp and say yes, at which point you've wasted the time. If it was going to go through anyway what good does it do to have it go through all these steps and get this automatic stamp? You've got to have an impact. You either deny the project or have to change the project or do something like that. And it takes a certain amount of guts to do that. Somebody has to stand up to the authorities in order to effect a change. And that was Ernesto. Ernesto once stopped [the construction of] a whole line of the metro because it was premature. He did it by articles in the *Mercurio*, and it succeeded because he had the prestige.

05-03:04:50

Burnett:

Right, right. Well, yeah. I guess that is a key piece of pedagogy, right? It could be painfully dull, project evaluation, as you say, if it's just rubber stamping. So social science as science in general Science is social, right, and it has that element to it? I think that the personality or the charisma, you've talked about great leaders and these great figures, the heroes of yours, but it sounds like you have a kind of hero in the pedagogical domain, too.

05-03:05:31

Harberger:

Absolutely.

05-03:05:33

Burnett:

And that's a piece of it, right?

- 05-03:05:33
Harberger: Absolutely.
- 05-03:05:35
Burnett: So it was a kind of mixed success and not a success in that it just didn't continue in Argentina or it didn't continue in Mexico.
- 05-03:05:43
Harberger: In Argentina, various things got interrupted with the crisis of 2001, 2002. In Mexico things got screwed up. The Mexicans had their crisis called the *Tequilazo* in October-December 1994. And both countries had a big issue, a big devaluation debt crisis such that budgets had to be slashed at that time. Many things that had gone on before were squeezed out. My Argentine thing went virtually up to the brink of the 2001 crisis. I was there two, three times a year, all by myself, with all those blue books. [laughter]
- 05-03:06:47
Burnett: So you did that repeatedly?
- 05-03:06:50
Harberger: Yes.
- 05-03:06:50
Burnett: Oh, my goodness. How long did that take you to get through?
- 05-03:06:54
Harberger: Well, I would go there for two, three weeks at a time. I wouldn't be on the blue books all the time. And I got to sampling and things like that. I got to knowing which of the professors were more relevant targets for me and working on them in particular.
- 05-03:07:16
Burnett: Well, during this time there seems to be no shortage of economic crises. But in 1997 there's the Asian crash and that hit a whole number of—
- 05-03:07:27
Harberger: Ninety-eight, yeah. Ninety-seven, '98.
- 05-03:07:29
Burnett: Ninety-seven, '98. And hit a number of countries really hard. And one of them in particular was Indonesia.
- 05-03:07:38
Harberger: Yeah. Well, that was a serendipity thing. Real serendipity.
- 05-03:07:48
Burnett: Is that the Gillis connection?
- 05-03:07:56
Harberger: My work with Gillis in Indonesia was mainly in '80, '81. And we had overlapped in Indonesia earlier than that, in the late sixties and early seventies.

And I had been with HIID in Indonesia around '85 with Glenn Jenkins. So this time it was basically AID. And the idea of AID was to get a cadre of people — and I think Gillis was to have been one of them; Anne Krueger was to have been another and I was to have been another — to come at regular intervals and sort of stand side-by-side with key ministers and central bank people and sort of share with them whatever problems they had. So in any case I was one of the first to visit and by my first visit the Asian crisis had already come down on Indonesia's head. And so I was able to make a speech based on the experience of Latin American countries with similar crises, with graphs and things like that to show exactly how it happened. This is what happened first, this is what happened second, this is what you guys can expect. And that gave me a huge entrée into their confidence. The snake oil that I had acquired in Latin America was really the snake oil that they needed. [laughter]

05-03:10:06

Harberger:

So I kept coming back to Indonesia and working with the central bank and I have a series of papers that I wrote at that time that went into their problems in some detail, and I think was very successful. And then actually I made good use of these Indonesia papers when I subsequently, starting in 2000, started to work in Russia where some of the problems were similar to what had been in Indonesia.

05-03:10:46

Burnett:

In terms of the real exchange rate problems?

05-03:10:50

Harberger:

Real exchange rate problems, yeah.

05-03:10:52

Burnett:

Okay, okay. And it's a unique country, as well, right? So it's a petroleum-exporting nation but it's got a wide—

05-03:11:07

Harberger:

Well, all of those islands, a thousand islands all over the place.

05-03:11:10

Burnett:

Right. Ethnic groups, languages.

05-03:11:12

Harberger:

How do you deal with smuggling, among other things?

05-03:11:20

Burnett:

There was a Cold War struggle. Sukarno was out in '65 and then the Suharto regime came in and there was a very bloody history.

05-03:11:33

Harberger:

Well, that was earlier.

05-03:11:33

Burnett:

That was much earlier, of course. But there was a long period of trade liberalization. The way it's been described in some of the reading that I've done is that there are a lot of traditional supports for social protections, programs, sometimes what gets interpreted outside the country as corruption. Was that a particular challenge that you were dealing with?

05-03:12:11

Harberger:

I did not deal with social programs when I was there. I was dealing with the central bank, finance, and planning, those three ministries.

05-03:12:26

Burnett:

So in 1995 there was an International Monetary Fund conference and out of that there was a paper that you wrote called "Monetary and Fiscal Policy for Equitable Economic Growth." According to, I think it's Glenn Jenkins, this became the basis for a renewed interest in the design of tax systems in the late nineties. So you were thinking about this. Can you talk about how your thinking was evolving with respect to the design of tax systems roughly in that period? What was of concern to you?

05-03:13:20

Harberger:

Well, let's say first of all the public finance fraternity likes taxes that are as little distorting as possible and the rough rule there is to have them at relatively low rates that are not too different from one piece to another on the same tax and on a broad base. So if you have a value-added tax you want a low rate broad base. If you have a personal income tax you want it low rate broad base and so on. So some people get all enthused about uniform tax rates. I think that they have a bit of their pie in the sky. I have always been in favor of progressive tax rates on some people, if only to have a uniform end result. Consider the value-added tax, which is a good tax, which has quite a broad base, but never the whole economy by any means. You don't tax hospitals, you don't tax medical schools, you don't tax universities, you don't tax this, you don't tax that. And by the time you're finished you're lucky if you tax half the GDP, not the whole GDP, as some textbook would have you think. But it's a good tax and it is the most money-raising tax in the world today. So at a uniform rate, I like it. But, when you have that, especially in a developing country, that's regressive for the population as a whole, if only because the rich spend a lot of their money out of the country and they also spend a lot of their money on those services that are not taxed. So between all of that, how are you going to make them equal even? You need a progressive part of the system. Well, that progressive part of the system has only two sensible things. One is scaled taxes maybe on certain luxury consumer goods, and the other thing is a progressive income tax. And so you got a progressive income tax with rates like in Chile going up to 40 percent. Okay, that's fine. Let's not fight it, on top of a value added tax. And I am not sure that that leads to a progressive tax system as a whole. But I think if you're talking about progressivity and regressivity it is stupid to deal with an individual tax except as a component of a whole. Because the ultimate regressiveness or

progressiveness is of the whole and nothing but the whole, so to speak. So I do favor that kind of thing.

I remember in various papers that I did over a period of the nineties and the two thousands and so on, I explored what I thought was a nice model, and that is, consider a country in which the revenue of the government comes in proportion to people's income. And there are some generalized expenditures of the government, like military and administration, which I call unallocable. We don't worry about them. But then you have the allocable ones, like people get education, people get this and that from the government. So those benefits on a per capita basis, instead of them being in proportion to the income of the people, they're in proportion to their numbers. And so you get an implicit modest redistribution coming from the fact that you're extracting the money in proportion to income and you're giving these allocable benefits in proportion to numbers. I made some examples about that. Just numerical examples to show what it would mean with plausible income distributions and population orientation and so on. I was able to ask myself the question, I am not sure that many countries have more redistribution than this. In the United States, when people try to allocate the tax burden, if there is a center of gravity among the studies it's basically in proportion to income. And if there's a modification that you want to make on that it probably would be that the corporation income tax is borne by labor and that makes it less than in proportion to income, less progressive. I think that way of thinking is helpful for the profession, but it shouldn't be thought of as a rule or a goal. Like we have Greenwich Mean Time. Why Greenwich? No good reason why Greenwich but that gives us a base. And you need something. You have the Cobb-Douglas function, nothing sacred about it but it has a property that you can say there are those that are more elastic than the Cobb-Douglas and those that are less elastic than Cobb-Douglas and these behave this way, those behave that way. Nice to have these canonical pieces. And I thought that I was presenting such a piece that dealt with the impact of government distribution, taking into account both the tax and expenditure sides.

05-03:20:53

Burnett:

If there's a theme that seems to come up when you're talking about the problems that you become interested in, I think one is that you are constantly trying to look outside of the narrow purview of one type of analysis or one kind of model or framework. You're trying to see what's hidden or spilling outside on the margins of the thing that economists are trying to analyze. I don't want to get into real exchange rate stuff but this is what you were praising the Chileans for doing, trying to look at what is—the phrase is escaping me right now. This is a question of Ricardian equivalence, the tendency to treat increases in debt and taxation as equivalent. And so your position was you should need to look at the system as a whole and that was an important lesson you were drawing. And the example that you gave was actually Argentina, all this by way of saying that you're trying to think outside of conventional frameworks.

05-03:22:36

Harberger:

Well, Ricardian Equivalence is itself a thing. Ricardian Equivalence is a theorist's toy. You can see how if you think of a totally rational humanity—if you and your wife go into debt, that's an expenditure just as much as if it were done by cutting something else. It's the same. So Ricardian Equivalence says that it doesn't make a difference. People behave the same if the government goes into debt to spend money or if it taxes to spend money. Well, anybody in his right mind looks at that and says crazy, no? But the underlying idea is that people anticipate the future taxation which will pay off that debt and thereby curtail their expenditures in the same way as they would if that were being taxed currently. And a totally rational human being might behave that way, but what is the truth? The truth is that when the government goes into debt by ten billion dollars you and I don't even know about it, let alone go home and say, "Honey, take that steak off of the grill and put on a Hamburger Helper," it's not rational for us to react to the government going into debt immediately. Why? Because we don't know when that government is going to tax to cover that debt. We don't even know if we're going to be alive. We don't know if they put a tax, it's going to be a tax that hits me or hits the sugar producers. So when am I going to react to this tax? Well, I'll surely react when it comes but I might even react somewhat when it starts getting debated in Congress and I might react when it starts passing one house of Congress and then another and the president signs it and all that, even though I haven't got a bill. But it's in that frame that I'm going to be thinking rationally about this tax, not at the moment when the government just adds to the amount of bonds outstanding. And all of the empirical evidence on Ricardian Equivalence bears me out, that people do not react so fast. But Ricardian Equivalence has serious good economists who like it, like Bob Barro, who's nobody's fool. But I think that's an example of a thing that is quite common with me and that is things that are sometimes widely accepted at the theoretical level, when you really get down to look at them and how they work in the real world, they work all right but they work differently from what the theory people expect.

05-03:26:37

Burnett:

Right, right. So again, looking at the real world is a key to that. So in this time period, during the 1990s, you're also of service to the American Economic Association. So you become president-elect and then president of the AEA.

05-03:27:03

Harberger:

Yeah. Well, I first was the Ely Lecturer with "The Search for Relevance in Economics. That was in like '92 or '93, and then I became vice president and then president. As president-elect I had to do the program and as president I had to make the presidential address. So we did all those things and I was reasonably happy. And I organized the program about economics in action and I tried to get people who were tillers in the field, so to speak, to be the bulk of the program. And I was happy and I think most people were happy with the program. And "The Search for Relevance in Economics," that's one of my sermons.

05-03:28:08

Burnett: Yeah, it is.

05-03:28:13

Harberger: I think the “Vision of the Growth Process” is in a way another sermon, although it is more empirically oriented than the other one.

05-03:28:23

Burnett: And this is the paper where you were explaining the disciplines moving beyond residual r , not just the human capital contribution, not just technical change, but something that you call—

05-03:28:43

Harberger: Real cost reduction.

05-03:28:44

Burnett: —real cost reduction.

05-03:28:45

Harberger: Yeah. It's just a name. Everybody did the same thing. Everybody said, well, here we have this growth. Now, some of this growth comes from extra labor. Suppose we had this extra labor. What does it produce? It's supposed to produce this marginal product. What's our best measure of the marginal product of a worker? His or her wage. So let's give each extra worker their wage. Let's see how much that explains. Then we have capital. Well, we have a bunch of investments being made and these investments have rates of return. So we take these investments and we apply to them their rate of return. Well, we thus have some amount of growth explained by increased labor and some by increased capital. But there's some growth left over. Where does that come from? Well, some people say it's a shift in the production function. Some people say that's innovation. Some people say it's human capital accumulation. And people have all sorts of labels that they want to apply. And I say, “Well, it's all of those things.” And if you make a model in which one of them is carrying the whole burden that model is going to be grossly unrealistic. And you have to think of the real cost reduction as coming from all of the factories and farms and other establishments all throughout the economy and it takes all sorts of forms and it's very hard to predict and it doesn't have a hell of a lot of serial correlation to it. You can't say that next year's real cost reduction is going to be similar to this year's. So it remains a kind of an outside force in our story. I treat it as that. I think we want to study it and learn more about it and we started a little bit to do that. I emphasized the many cases of negative real cost reduction which I don't remember anybody paying much attention to before my presidential paper. And it turns out that in most distributions of this, maybe a third of the entities had negative real cost reduction. And what does this come from? Well, it comes mostly from their being squeezed by other competition of some sort. They're being rendered obsolete. And when they're rendered obsolete they still have their equipment and they still have their labor force and yet they're getting less output and

therefore a negative difference – a real cost increase instead of a real cost reduction.

05-03:32:10

Burnett: This is kind of the creative destruction of capitalism?

05-03:32:13

Harberger: The creative destruction comes into that in the sense that the new squeezes out the old and in the process of squeezing out the old generates this negative real cost reduction.

05-03:32:26

Burnett: Right, right. I thought this was very interesting, this distinction you make between yeast and mushrooms. Can you talk a little bit about that? That's really perhaps quite instructive in explaining because you're—

05-03:32:52

Harberger: Yeah. Well, the process of growth includes this contribution or contributions coming from incremental labor. Same thing coming from incremental capital. And then this real cost reduction story. Well, in making a simple model, people usually write a production function where they have L to the α , K to the one minus α , e to the λt , where λ is this rate of real cost reduction. When you look at it that way the real cost reduction is kind of a generalized thing that's spread over the whole economy and you think of it as coming all over the place, all sorts of activities sharing in it. Well, on the record that is absolutely totally utterly false. No matter where and when you look, the real cost reduction is highly concentrated. Most of the time, maybe a third of all activities account for the full real cost reduction in the economy. And then you have some more that account for further cost reductions, but they're balanced by others whose contribution is negative. So I divide the graph into three portions. The first are when you get the growth champions and render them in descending order of their contribution to this growth. How fast do they explain what the whole economy has seen? Then beyond that you have more growth but that growth is canceled by negatives. I think that's a nice way to look at it and gives you three areas, so to speak. Three segments of the economy. The first segment is the one that's really piling on the growth. The next group is adding a little bit and the third is subtracting what the second group added.

05-03:35:00

Burnett: Right, right. So it could appear yeasty but in fact it's like these dynamic—

05-03:35:05

Harberger: Now, yeast would be they all contribute the same and my graph would be something like a straight line. But it's not that.

05-03:35:14

Burnett: I think part of that article, too, is about the unpredictability. It's not super path-dependent, is it, in the sense that going from decade-to-decade—

- 05-03:35:29
Harberger: You can't say what was flashy in one decade is going to be flashy in the next. Absolutely not.
- 05-03:35:32
Burnett: Yeah. It's astonishing, isn't it? And there's an implication to that, too. It's another implicit indictment of planning, of a planned society. If it's not really predictable, easily predictable from one decade to the next, what is going to be this leader of real cost reduction?
- 05-03:35:59
Harberger: Right, right. Who would have thought of fracking a decade back?
- 05-03:36:05
Burnett: And so the mathematical part of this is the sunrise/sunset diagrams. Those were interesting. Has this been taken up? What's the legacy and the impact of these insights for research and policy?
- 05-03:36:26
Harberger: I have no idea what happens—
- 05-03:36:31
Burnett: How was it received at the time?
- 05-03:36:33
Harberger: It's sort of unpredictable to me. There is a branch of growth economics which Bob Lucas is a member of and some of the Minnesota people are members of, Ed Prescott is a member of. And real business cycle theory is sort of the underlying label under which their work is usually classified. And I have always found that too stilted, too tight, not related to the real world. But I went up to Minnesota and I gave a paper on this stuff and Ed Prescott was there and he fell all over on me. He said, "Oh, how wonderful." And because one of the premises of their real business cycle theory is this unpredictability of the real cost reduction component. And since I was giving a strong endorsement to that particular thing, they loved it. [laughter] But they weren't with me to the degree that I was skeptical about a lot of the rest of the stuff they do. [laughter]
- 05-03:38:24
Burnett: It's funny that, reminiscent of your monopoly paper in 1954, your story is that you're facing a deadline and you whipped out this paper in a month and then you never worked in that area again. But it's had this huge impact. A whole train of research has been conducted in that area. I wanted to maybe save this for tomorrow but the tax stuff that you've done, I noticed when I was doing research through news articles that mentioned you, and I noticed an uptick in policy advocates in the early two thousands pushing for tax reform in the United States, including one figure who's with the American Council for Capital Formation. I don't know if you've worked with that organization before.

05-03:39:34

Harberger:

Oh, yes. One of my papers was written specifically for them.

05-03:39:38

Burnett:

And they're moving to reform the corporation tax in the United States. And it's interesting because in the article the reason that they were giving for this, the necessity of this reform, was that other countries that have a value added tax, they can give tax rebates at the border as they're exporting but because of the tax system in the United States—and there is no way you would get a value added tax at the federal level in the United States— they're unable to do a similar thing and so American corporations are getting taxed twice. Once directly, and in the other sense indirectly. Is this something that you're interested or you have been interested in in terms of the reform of US taxation?

05-03:40:42

Harberger:

What can I say? If you are living in the stratosphere of economic theory, you don't like any taxation of income from capital; you only like taxation of labor. If you're living in the real world and you try to do that, you're going to get your head chopped off practically and you should. The issue is that all taxation has efficiency costs and what we should try to do is to keep efficiency costs within bounds but try to have a tax system that, while respecting efficiency to the degree possible, also meets our standards of fairness. And I think the corporate income tax still has a place in that. I wouldn't feel comfortable eliminating it.

05-03:42:14

Burnett:

Did they push for elimination? The American Council for Capital Formation?

05-03:42:16

Harberger:

The stratospheric economists—

05-03:42:19

Burnett:

Oh, I see. I see. Okay.

05-03:42:19

Harberger:

—definitely do. And some others. One or more of the candidates wants to eliminate the corporation income tax and have a uniform tax, a single tax, and they have different single taxes. Each candidate has a different single tax. But we're not going to get one of them and I don't think we should get one of them. My basic thought there is that every tax that you make has big holes for evasion. And some group is going to be able to evade tax A legally, avoid it legally. Another is going to be able to avoid tax B, another tax C. So if we get part of our revenue from one, part from the other, and part from the other, we're not letting anybody get away scot-free.

05-03:43:23

Burnett:

[laughter] Distribute the evasive burden.

05-03:43:27

Harberger:

Yeah. Let them cry. At lower rates they evade less. That's for sure.

05-03:43:35

Burnett:

Yeah. That is one of the things that you identified early on, isn't it? So one of the things that comes online at this point is the General Agreement on Tariffs and Trade morphs into the World Trade Organization.

05-00:44:00

Harberger:

The fact that you rebate the tax on exports and impose it on imports.

05-03:44:06

Burnett:

Yeah, that kind of stuff.

05-03:44:08

Harberger:

Well, that's in there for all indirect taxes. And I have two papers on that subject called "Border Tax Adjustments". I think you're going to find them in my book, *Taxation and Welfare* actually. They were done for one or another US department way back in the sixties or early seventies.

05-03:44:28

Burnett:

Yeah. No, we did talk about that briefly, yeah, in a previous session.

05-03:44:32

Harberger:

The thing is that the economy adjusts to these things. It isn't that they're getting away scot-free. What the border-tax adjustments do is they convert a production tax into a consumption tax. So if you have a production tax you're going to tax all the copper that's produced in the United States. So when we export copper a foreigner is going to pay that tax. And when we import copper there is no tax. So now what do we say? Well, what we're going to do is we're going to take away the tax when we export and we're going to apply the tax when we import. So now our consumers are paying this tax and the foreign consumer is not. That's straightforward. Nothing wrong with it. I don't think it's a great advantage. It's just we're converting a production tax into a consumption tax. [laughter]

05-03:46:00

Burnett:

Right, that's it. Okay. That's about as far as it goes. Okay. Well, one more thing before we break today. I wanted to ask you about a happy event. You were elected to the National Academy of Sciences in 1989. Can you talk a little bit about that?

05-03:46:20

Harberger:

Well, I can tell you I was in Santiago, Chile and I was doing one thing or another and I don't know exactly where. I think the Center for Policy Studies was one of the places that I had a kind of a base. And I think it was there that a telephone call came for me that I was supposed to call John Simpson. Now, John Simpson was the second husband of Harry Johnson's wife, Liz Johnson. So she became Liz Simpson. And he was a guy, a scientist who created the measuring items that NASA sent around the planets and the sun to measure

the various aspects—he was a very well-known physicist. So he calls me up and says, “You’ve been elected to the NAS.” I said, “Oh, my God.” And I was utterly thrilled and I still feel that the NAS is a prize that is at least as valuable as the Nobel Prize and has in terms of numbers, it probably has fewer than the Nobel Prize, though more concentrated in America. But the other thing is that we are elected by ourselves, so that the kind of social and political considerations that may govern Nobel committees, which everybody realizes, that Scandinavians do better and so on, they every now and then have to put a Japanese or an Indian. You know, it goes like that. And in the NAS the nominations come around every year and everybody ticks off the ones that they think are most worthwhile and then there’s a second ballot where these worthwhiles are concentrated and then you have to vote among these most worthwhiles. And people get elected and I think it’s an honor that has been given you by your own colleagues and it serves in that sense as a good recognition.

05-03:49:37

Burnett:

Absolutely. Well, I think let’s stop for today and we’ll pick up tomorrow morning.

05-03:49:44

Harberger:

Excellent.

[End of Interview]

Interview 6: March 22, 2016
Session 6A, Morning

06-00:00:00

Burnett:

This is Paul Burnett interviewing Dr. Arnold Harberger for the Economist Life Stories Project. This is the sixth and final day of our set of interviews. And this is with the University of California Berkeley Oral History Project and the Becker Friedman Institute at the University of Chicago. And we're here in LA, which is fitting, because we're now at the stage in your career where you've relocated to Los Angeles and joined the faculty at the economics department at UCLA. And we were talking last time about the program. Well, we didn't talk in detail about the program that you were able to build up. So let's keep it in LA for a while and talk about some of the things that you were involved in here. Can you talk about the Program in Latin American Economic Studies?

06-00:01:11

Harberger:

Yes. Well, as I mentioned yesterday, no matter where I got an offer from I always wanted to have some kind of a replica of our Latin American operation at Chicago to be implanted in the new place. And far and away the most receptive and generous place in that connection was UCLA. And a bit serendipitous because they happened to have half a dozen very good Latinos from good places and were very enthusiastic about those Latinos and kind of wanted more. So to give me what I wanted was something that came very easily to them because it was what they wanted, too. And so we ended up with maybe a quarter to a third of the department at times being Latinos. And with these guys getting better than average grades and finishing PhDs in better than average times and having better than average quality PhDs and when they went into the American market getting top jobs. When they went back home getting good jobs. And a genuine source of pride for all of us. I don't know if I mentioned our feeding the IMF.

06-00:02:58

Burnett:

You did a little bit, that they're overrepresented in some way. [laughter]

06-00:03:04

Harberger:

That we have been in recent years the top single feeder of the IMF Young Economists Program, which is one of the most competitive things in economics in the whole world. And we're very proud of that.

06-00:03:20

Burnett:

Yeah. And has the Program in Latin American Economic Studies continued there or is it mostly associated with your professorship?

06-00:03:31

Harberger:

Well, it did. It always came through me, as it were. As my involvement sort of petered out, as I was taking leaves toward the end and working to retirement and finally retiring, the Latin American element sort of just evaporated. But now we have so many other professors from Latin America. We're now

loaded at the faculty level with people whose backgrounds are in Latin America and who are very good. I would say, however, that the old emphasis on sort of macroeconomic policy, real exchange rates, central banking and so on, that sort of has given way to more minutious things. Studying medical experiments where you have a sample group and a control group and that kind of thing.

06-00:04:52

Burnett:

Health economics.

06-00:04:54

Harberger:

So it isn't the same in that sense. But our time with the Latin Americans was really good. When I responded at one earlier point that the parties made such a big difference I think it's even more than that. Some former students created a book and they had this book as the centerpiece of a breakfast at the recent Alamos conference, so we had a kind of a session on that. People would be talking about their relationships with me and my background and so on. And it was amazing. What they were talking about was how we had them sometimes staying in our house when they didn't have any other place to stay and then how we had a lot of furniture that we lent out to them and they would bring back the furniture and then the furniture would go to another Latino coming in who didn't have furniture. This element of family-type relationship overwhelmed—I was waiting. When are they going to talk about real exchange rates? When are they going to talk about tax incidence—[laughter]? All they wanted to talk about was this stuff. But that element of humanity, so to speak, seems to have been a big piece of the glue that kept the Latin American mafias together and created the warmth that has always existed. We had the big house in Chicago where we had them at any available opportunity, practically speaking, and actually here when we bought Bell Canyon, which you saw, another big house, it was advertised that it had room for fifteen cars to park. I saw it in the ads and I thought it was way beyond my means to buy. But what happened was when I got my retirement from Chicago I had TIA-CREF money at my disposal, of which I could access half to do the down payment on Bell Canyon.

And the first party that we had in Bell Canyon was a Latino party for somebody who was just finishing or who was at some critical point in their career. This was a Saturday afternoon party more or less centered around the pool. And while this was going on the people from Sears Roebuck were moving in the furniture that we had bought. We bought a lot of the furniture that was in the house already. But we also bought new furniture of our own and they were bringing that in while we were having our first party. They had so much fun there. These parties would start a little after noon and we'd have shrimp and cheese and things like that inside. And then when the sun started to go over the roof, so we had a little shade, we'd move outside and we'd have kind of Asado barbeques out there going on into the evening hours, people jumping in and out of the pool and so on, and a lot of discussion of

economics, too. When we were around the tables there that was more where I could vent my spleen, as it were, on the pieces of economics that I didn't like and why I liked what I liked and so on. That came out much more in these more informal contexts than in the classroom where I would have a more disciplined approach.

06-00:10:04

Burnett:

Well, it's a very different portrait of the dismal science, right? [laughter]

06-00:10:08

Harberger:

Not very dismal.

06-00:10:10

Burnett:

Not very dismal. Yeah. This is something that so many academics that I've talked to—when you talk about thought leaders who have large succession of cohorts who know each other and know that source person—and it's not necessarily just one person. But it's a context where people feel comfortable, and especially with international students. So many stories I've heard about how important it was, the element of welcoming and home, because these people are very far from home and they're taking huge risks often in coming to the United States to be trained. And so many people speak warmly, not just in the Chicago case but in fields like paleontology and pharmacokinetics and mining metallurgy. It's just this style of informality mixed with the seriousness of the work and that that makes a social glue that is really, really important and can often be generative of new ideas.

06-00:11:29

Harberger:

And they truly never forget it.

06-00:11:30

Burnett:

Yeah. Obviously, right.

06-00:11:32

Harberger:

Rolf Lüders comes from the late fifties, early sixties and Alvaro Donoso came from the middle sixties, let's say, and by God, that loyalty, that spirit is still there.

06-00:11:57

Burnett:

You've talked about how in some cases it works; in some cases it doesn't. Not necessarily in a teaching sense but trying to recreate a social context for education or reform, transplanting one model that worked.

06-00:12:21

Harberger:

I think when you were talking about when we have Ernesto Fontaine being a key person in Chile and we don't find another Ernesto Fontaine in those other places, that aspect is certainly there. Without being immodest, I think my role, among both the Chicago mafia and UCLA mafia, was like that of Ernesto Fontaine: to infuse spirit and enthusiasm in these guys as much as to pour certain ideas down their heads.

- 06-00:13:06
Burnett: Right, right. Well, I think there's a mixture of charm, I suppose, and intellect. There has to be the content side, the rational side, but there has to be this—
- 06-00:13:20
Harberger: And Anita, of course, was truly the mother of these people and she talked to the wives and when they had babies she was always utterly attracted to every baby that came. And followed them years later. And that, too, adds to the glue that is binding this group together.
- 06-00:13:48
Burnett: Yeah. A sense of family, quite literally, right?
- 06-00:13:52
Harberger: Exactly. Yes.
- 06-00:13:53
Burnett: That's an important case. So this was a celebration just this last year.
- 06-00:13:57
Harberger: This was just a few weeks ago.
- 06-00:14:02
Burnett: So making part of this Chicago model, there is an element of the social to it. And this is carried over to some degree at UCLA. You have students from UCLA who come back and see you and you see them and you work with them.
- 06-00:14:25
Harberger: Of course, of course. And the guys I meet in Washington all the time, we have our tertulia in Washington. The son of López Murphy. López Murphy was my student in Chicago, was twice minister in Argentina. His son is in the IMF and had the great luck of having his main countries be first Spain and then Greece. Can you imagine that piece of luck at this time?
- 06-00:14:49
Burnett: A kind of luck, yeah.
- 06-00:14:49
Harberger: Anyway, we have these tertulias, we call them, and we get together with three, four, five former students and have dinner and we talk five hours about all kinds of economic issues.
- 06-00:15:12
Burnett: Well, you mentioned in between our sessions last year you had fallen and hurt yourself in DC and you were laid up in the hospital. Can you tell us about what happened while you were in the hospital? You were getting visits.
- 06-00:15:29
Harberger: Oh, yes.

06-00:15:31

Burnett: You were holding court in the hospital.

06-00:15:33

Harberger:

I had, I think, fifteen visitors. I was in GWU Hospital, which is walking distance from the IMF and World Bank and so on. And I had something like fifteen separate people—Anne Krueger was one of them. So she was not one of the Latinos but she is a dear friend. But just about all the rest of them were former students, Latin students and their wives. Some of them wives, some not. But I was so, so happy to be there and felt so lucky and had such a good time. It didn't seem like I was in a sick bed at all. They brought me cakes and other things to make myself fat. [laughter]

06-00:16:40

Burnett:

So it's a different portrait of what some people might consider to be a dry field. Maybe it's because there are these real-world problems. There's a lot of challenges—

06-00:17:01

Harberger:

Well, let me tell you another story if you want to get into that. This is way back. We mentioned Ernesto Fontaine and Sergio De Castro. Well, another who was in that group was Pedro Jeftanovic. And he came from a wealthy, originally Yugoslav family. But they had a large ranch in the outskirts of Santiago and were really quite wealthy. So one weekend we decided we were going to go on horseback up into the Andes. So Pedro rounded up horses for all of us and we packed lunches and so on and we went up the trail all the way up to the snow. So we were up there in the snow. And they had rifles with them and they were going to shoot condors. So Anita and I stayed with the food and they went up further looking for the condors. And what happened was we were there opening the food. And what did we see but two big condors circling over us eyeing our food. And we were yelling, "Condores a la vista." And they couldn't hear us. [laughter] We were lucky that the condors didn't come down and steal our food.

06-00:18:57

Burnett:

A case where supply and demand did not reach equilibrium. [laughter] Wow. And that was just a group of economists, a group of Chilean—

06-00:19:08

Harberger:

We were one, two, three, four, five people.

06-00:19:14

Burnett:

So there are these connections and friendships that are cemented over time. One friendship you had, a longstanding friendship goes back to Chicago but not on the student level, on the faculty level. So George P. Shultz is someone you've kept in contact this whole time.

06-00:19:32

Harberger:

Yes.

06-00:19:36

Burnett: You mentioned in earlier sessions that you went with him to—

06-00:19:40

Harberger: When he was Secretary of the Treasury we made these two big trips, one in Latin America and one in East Asia.

06-00:19:48

Burnett: Yeah. And so you talked about those. But now that you're back in Los Angeles you also kind of join up with George Shultz again on another initiative.

06-00:20:04

Harberger: Yeah. That was utterly crazy. I don't know quite how to describe this thing. He was coming down from being Secretary of State. He was sought by all universities practically over the whole country. He is a true statesman and he revealed his integrity to the nth degree while in office and he has this huge respect all over the world. So he had a lot of bargaining power and he used his bargaining power at Stanford to have this Institute of International Studies and to have this with an advisory commission, with the members of the advisory commission to be named by him. And this advisory commission to be adequately funded so that it is able to function. So somehow I am invited to be a member of this advisory commission. I'm the only pure academic on the advisory commission. There were people who were there because they had been secretary of this or of that and then were drifting into an academic job. But I was never any of those other things. I only was there from an academic role. We were seated in a kind of a U-circle with George as chairman down at the foot of the U. And we were alphabetically ordered. So I sit down in my chair and on my right is Valéry Giscard d'Estaing and on my left is Lord Howe. And down there is Paul Volcker and Lee Kuan Yew and Helmut Schmidt.

06-00:22:16

Burnett: Wow.

06-00:22:17

Harberger: And Bob Bradley. Senator Bradley. Senator Lugar was there. I felt I was in seventh heaven in terms of the quality and honor of the atmosphere and I often wondered how did I get into this thing. But this went on for ten years and we had just wonderful times.

06-00:22:52

Burnett: Well, George Shultz had finished his time as Secretary of State and he's situating himself there at Stanford.

06-00:23:02

Harberger: Yeah. [Anatoly] Dobrynin came one time.

06-00:23:04

Burnett:

Wow. Well, apropos of that, the Soviet Union is no longer during that period. Helmut Schmidt is an old friend of Shultz's. And they went through that whole Cold-War denouement. And I imagine the subject of discussion would have been something like, "What's next?"

06-00:23:34

Harberger:

Well, I can remember one thing. It was at the time when the Gulf War had not yet gelled, so to speak. Saddam Hussein had invaded Kuwait but we weren't really doing anything about it. We were working up maybe to do something and so on. Lee Kuan Yew said, "This world has a lot of potential turmoil. And there is no way that it can stay stable unless somebody is really helping to keep order as the British did when they were masters of the seas. There's only one country that has the potential to occupy this role and that is America. But I'm not sure its leaders have the balls to do it." [laughter]

06-00:24:56

Burnett:

He said that? [laughter] Okay. All right.

06-00:25:03

Harberger:

He was a tough guy. The rumor has it that when he went through Oxford or Cambridge he had the highest grade in a couple of centuries.

06-00:25:18

Burnett:

So that's a very illustrative introductory anecdote. You got to know him a little bit?

06-00:25:27

Harberger:

Well, he was around the table. I didn't sit there and have tête-à-tête conversations with Lee Kuan Yew but we had these discussions in which he played a significant role and if I was anything it would be more forward than would have been warranted by my place, as it were. And I did that because I was the representative of good economics there. You know what I mean? There was nobody else who could speak with the degree of confidence that I had on lots of economic issues and so I would be going toe-to-toe with Helmut Schmidt on the German problem.

06-00:26:24

Burnett:

On reunification and all of that.

06-00:26:26

Harberger:

It really would have been ideal had they had a separate currency for the East, which was much devalued, so that labor in the East would be much cheaper than Western labor. And the idea that they had the common currency led to serious unemployment in the East. They had [minimum] wage laws that should have been lower in the East so as to absorb the unemployed. It was complicated. But there were political as well as economic reasons lying behind their policies. And looking back you can't sneeze at the success that they have had.

06-00:27:25

Burnett: That's true. It did work out in the end at least for the—

06-00:27:30

Harberger: Yeah, but they had a lot of suffering in that process.

06-00:27:33

Burnett: Yeah. Oh, absolutely. You'd think that most of the people at that table would have been roughly aligned with your way of seeing things. But there were points of disagreement on the specifics of policies. They were thinking broadly about global issues, so not just Germany but they were thinking about—

06-00:28:00

Harberger: Oh, they talked about anything that was sort of in the news or looming, always contemporary issues and always lots of opinions.

06-00:28:15

Burnett: Was the goal to produce some output or have some kind of policy papers?

06-00:28:22

Harberger: No, there were transcripts and videos. In the early ones, they took videos of the whole thing.

06-00:28:31

Burnett: And it lasted until 1997 or so?

06-00:28:33

Harberger: Well, it went on afterwards but what happened was that when Bill Perry, who was a colleague, when he came back from Washington he sort of took the role of George and then the mix of people changed, including me and others from George's group. We disappeared from the scene.

06-00:29:01

Burnett: This is somewhat related to the fall of the Soviet Union. Backing up a little bit. You're invited to go to Poland in '89. Can you talk about that mission?

06-00:29:26

Harberger: Well, that was a very nice and interesting thing. This was at a time when the breakup of the Soviet Union had not yet taken place but it was on the cusp of that. Issues of Lech Wałęsa and all of that, they were in the air.

06-00:30:06

Burnett: Solidarity.

06-00:30:08

Harberger: It was quite exciting in those senses. And somehow George Bush forty-one sent half his cabinet to Poland to get a feel for the scene and get a feel for how each could be helpful in some sense in terms of the many difficulties which Poland might face as it maybe became independent and more independent or whatever. I was there as advisor to Mike Boskin, who was the chairman of the

Council of Economic Advisors and a cabinet member. So I don't remember that we were there solving huge problems but I do recall going back on the plane and somebody coming around and asking, "Do you have any suggestions as to what US policy should be from here on in arising out of your stay?" And I remember that I urged upon them a massive training of Poles in our graduate schools in economics as something that I knew would do well and urging them to pick graduate schools that weren't up there in the stratosphere, were down on earth getting their hands dirty and so on.

06-00:32:40
Burnett:

Well, at that time with the end of the Cold War, so getting into '90, '91 is obviously the fall of the Berlin Wall and the Soviet Union breaks up. And at the time there was so much optimism and there was a sense that people were toasting the freedom of these peoples now and everything was going to be rosy and there was a tremendous amount of optimism. Given your long experience with institutional inertia and somewhat painful adjustments, macroeconomic adjustments over the short and long term, what was your take on the end of the Cold War? What were you thinking at the time?

06-00:33:45
Harberger:

Well, let's say Poland was the place that I was a bit familiar with because of this mission. And the person that most impressed me there was Leszek Balcerowicz. I don't know if you know that name.

06-00:34:06
Burnett:

I don't know that name, no.

06-00:34:08
Harberger:

Anyway, he was finance minister or central bank president, I believe, if not of the high hierarchy, anyway, in the still-communist government of Poland. But he taught good economics all the way. And I was just praying that he would remain in power, so to speak, as the shift took place, which indeed did happen. And he is one of the European heroes of the transition from communism to modern economics in that part of the world.

06-00:34:56
Burnett:

Did you think that there would be a long cultural adjustment, the absorption of eastern Germany into the west? From what you were hearing, was there this sense that—

06-00:35:12
Harberger:

Well, I think we were all so aware of the thing that I talked about before, that they had the Ostmark and they had the Deutsche Mark and the Ostmark was cheap and the Deutsche Mark was expensive. And then when they imposed the Deutsche Mark all over the place that had a great signaling feature and all of that. But it brought along some very serious issues of unemployment and misery. Those who had the jobs at a Deutsche Mark wage were fine but those who didn't suffered.

06-00:36:00

Burnett: Yes, they struggled.

06-00:36:02

Harberger: And, of course, West Germany poured tons of money in in the form of relief of various kinds to try to help these people.

06-00:36:10

Burnett: So during the time that you've landed at UCLA, you're teaching, you're working in the advisory council of Stanford with George Shultz and you're continuing to go on consulting missions for the IMF and the World Bank. Can you talk a little bit about some of the most salient projects that you were involved in in the nineties that were interesting to you?

06-00:36:46

Harberger: El Cajón was a very interesting one.

06-00:36:50

Burnett: The hydroelectric project?

06-00:36:52

Harberger: El Cajón was a big multipurpose dam in Honduras. It was big enough that it would provide for the full electricity needs of the country and have plenty left over for export to other countries. And my job, I think this was for the World Bank, was to assess sort of the macroeconomic implications of it. And the thing is that this dam was going to cost something like half of a year's GDP for the country. The question as put to me is can this little frog swallow something so big [laughter] and not burst. And this was a wonderful exercise in real exchange rate economics in the sense. So as I went through that material it turned out that many of the inputs into this dam—obviously all the turbines and things like that were there. Many of the high-quality engineers were coming from abroad and so on. And the financing that was coming from the World Bank was basically paying for those things. So it was a big inflow of capital into the country but the capital didn't get there as capital. It didn't get there to make funds super available to anybody who wanted them or anything like that, push interest rates down, to do this and that. No, the capital came in the form of machinery being unloaded on docks and experts coming off of the boat and into the five-star hotel. And basically the swallowing was practically nothing, even though the amount was so huge that everybody expected it would be a big turmoil.

06-00:39:38

Burnett: This is something that's come up a number of times, this question of real exchange rate economics. And I'm wondering if you could set up the context. Does this become important as countries begin to float their rates in the sixties and seventies? Is it only evident [then] or is it something that was constantly an issue?

06-00:40:06

Harberger:

First of all, the real exchange rate is an ever-present thing. The real exchange rate is not bilateral. It makes no sense to say what is the real exchange rate with China, what is the real exchange rate with Canada and so on. No. The real exchange rate is a key link between this country and the rest of the world. That's what the real exchange rate is. And what you have is, in a market economy, at least, you have these tradables which have world prices. So they're part of the things that this country both buys and sells. So you've got the price of tradables. Now, what if you get a demand pressure coming in the economy? Well, it's going to demand more tradables, right? So they're available at those prices, they come in. But what about the non-tradables? You bid up their prices. So when a country undergoes a boom you get rents going up, you get house prices going up, you get the wages going up. Often all these things in the non-tradable area of the economy. So the relationship between non-tradables and tradables is key, and it changes under different pressures.

Now, when you have a big inflow of capital, not like the El Cajón Dam where it's all in kind, but just money coming in from the banks in the oil-price boom times, then people start spending this and they raise the prices of non-tradables, including wages, and the country in general has a boom. The price level goes up and some people want to call that inflation. I call that real exchange rate adjustment. And it works like that. So many people just do not understand these things. The real exchange rates were not talked about during the Bretton Woods period when the world as a whole was on fixed exchange rates. And as we got off of the Bretton Woods thing then we started getting these couple of big oil price spurts and real exchange rates went all over the place and attracted the attention of people. Actually those at Chicago who were involved, particularly Rudi Dornbusch, started to write the new literature on this subject. The Australians had already done so and we didn't advance too much beyond where the Australians had already been. But it created a new and very fundamental forever piece of economics, if you like. Having a place in economics that's like supply and demand and like the twists of labor economics and so on. It is very hard for you to think of macroeconomic issues without touching on the real exchange rate.

06-00:44:11

Burnett:

The Australians you mentioned. Is this associated with the university or the government or who was coming up with this literature —

06-00:44:20

Harberger:

I'm not good on these names. Trevor Swan was certainly one of them. Another two or three that I'm missing.

06-00:44:33

Burnett:

Okay. Just to anchor ourselves a little bit.

06-00:44:36

Harberger:

But anyway, Australia was a small country, very open, and one of the things with the real exchange rate in particular, when you have major exports that occupy a large chunk of your export base and are extremely volatile, like copper, like wool, like wheat—

06-00:45:06

Burnett:

Coal.

06-00:45:06

Harberger:

Items like these that go up and down in world prices, then you get real exchange rate shocks a lot, whereas if you have just manufacturing exports and so on or service exports like Switzerland or canal exports like Panama, you don't get much of that wiggle.

06-00:45:26

Burnett:

Right. So putting us back in that time, when economists and policy advisors did not understand this, they could interpret an influx of foreign capital for a dam project, let's say — because it would raise the general price level of nontradables and wages and so on — they'd interpret that as inflation and then make policy recommendations that would work counter to what was really going on at the real exchange rate level? What were the consequences?

06-00:45:59

Harberger:

We may be jumping ahead of ourselves but let me tell you the best lesson of real exchange rates and subtleties there. We had this conference in China in '95 organized by the IMF and Bob Mundell. D. Gale [Johnson] was there. I was there. Hiro Uzawa was there, who had been a colleague at Chicago. Mundell obviously was there. China had been suffering from inflation and we were trying to just make suggestions and recount experiences that could be helpful for them in further thinking about the problem. Well, partly through Mundell's enthusiasm for fixed exchange rates, they decided to stop the inflation by pegging the exchange rate, which they did in '96. Now, when you have a country with a fixed exchange rate and it has a whole lot of foreign currency pouring in and the central bank has to buy this foreign currency and has to issue renminbi, yuan, whatever you want to call them, in the millions and billions and billions year after year, just one year after another after another with all this money coming in, the money supply burgeons, multiplied by four maybe or something in five or six years, and the goddamn price level didn't move! And I was nonplussed by this result but I quickly saw that what was happening was that they were printing all this money and the people were happy to hold that money. That is to say, the inflation comes when you're giving people money that they don't want to hold and then they go and spend. But here they gave them money and they were happy to hold it. Now, part of the reason was their incomes were growing a mile a minute, eight or ten percent per year, and part of the reason was that the one-child policy had modified the usual social security of the Chinese family, which was your children will take care of you in your old age. Well, when you

had five children that's one thing. When you only have this one that's not so easy. So there was an incentive for the parents to build up—

06-00:49:11

Burnett: Savings.

06-00:49:12

Harberger: —savings and so on. And then there was the fact that they hadn't yet got around to the point where ordinary people put money in the stock market. The only place ordinary people were going to put money was in the bank, and that was part of the money supply. So they were taking these extra balances that were being created and storing them, partly because their income was higher and they were going to have higher balances anyway, but partly because they had to take more care of their old age. And then, in turn, partly because the other places that they later were able to put their money, like the stock market, the bond market, and so on, were ill-developed and not familiar to the people. So this kept the Chinese price level— incredibly — while the money supply was growing by four, the price level went over six years from 100 to 102.

06-00:50:19

Burnett: Wow.

06-00:50:25

Harberger: Less inflation than the United States. [laughter] Now, by contrast, Russia had a similar experience, that with the development of oil and gas in Russia, they had burgeoning exports of those things. They had big floods of foreign money coming in and so on. They didn't have a fixed exchange rate like China and it bounced up and down. But I went first to Russia in January of '00 and my last trip to Russia was in January of 2010. And in '00, the exchange rate was twenty-eight something to the dollar and in 2010 it was twenty-eight something to the dollar. So it had fluctuated in between but it is almost as if it had been fixed. Meantime, the price level had tripled. Tripled. And everybody was talking about inflation. And I kept trying to say, "Well, this isn't really inflation. This is a real exchange rate reduction. This is coming because of the great abundance of foreign currency that you are generating and when you have highly abundant foreign currency it's going to tend to be cheap." And it's very cheap. If you had tried to keep the price level constant in that period the nominal exchange rate with the dollar would have gone from twenty-eight down to nine. And it didn't do that. The authorities sort of didn't let it. I don't think the authorities rationalized it that way. But out of that experience grew a sense that I have, which is in my Russian paper, of a kind of a ratchet story, you see. You've heard so many times that, well, we're supposed to avoid deflation because of the downward rigidity and downward rigidity of nominal wages and so on. Well, suppose you have two price levels. Suppose you have a price level of tradables and a price level of non-tradables. If you're going to have a stable price level and a changing real exchange rate you're going to have to have one of them go down and the other up. And if there's a big change there's going to be a lot of that movement, you see. If the issues of

rigidity apply to these individual price levels maybe what you want is a ratchet, where the one that's supposed to go down stays put and the other goes up, you see. And then when it goes the other way the second one stays put and the first one goes up. When you look across the world at the trajectory of price levels they're always up. And you try to break this down, as we did as best we could, there is a lot of evidence to suggest that without people articulating it, without people talking about this dual price level, this ratchet effect and so on, this comes pretty close to mimicking the behavior that you actually observe in the real world: that people are letting the price level that wants to go up, go up, and somehow impeding the price level that wants to go down from going down or going down very far. All of that, that relationship between the non-tradable goods price level and the tradable goods price level is the essence of real exchange rate economics.

06-00:55:00

Burnett:

I think you've talked about this before in your writings. Scientists and educators lament the innumeracy of the population in addition to illiteracy. Do you think there needs to be more economics literacy? In our larger political conversations we seem to be having conversations that, by your lights, by what you've studied, so much has changed. Some of the old debates don't seem to apply as much. Would you prefer to have a broader public conversation about what this kind of stuff means or does it—

06-00:56:07

Harberger:

Listen to Mr. Trump talking about Mexico. "They're taking things from us." As if they're not giving us goods in return. We have a deficit in the balance of trade with Mexico. We give them money and they give us goods. What's wrong with that? Same thing you do when you go to the store. Now, to call that a problem is cretin economics. It's just awful. And I'm so distressed that other candidates, some of whom at least have had elementary courses in economics to be able to tell that, first of all, the only deficit that matters, is the overall deficit. You don't have a deficit with a country, you have a deficit with the world. Just think of simple examples of three-way trade. That A sells something to B, B sells something else to C, and C sells something else to A and that means each has a deficit in the thing that it's buying. But oh my God, that's not a problem.

06-00:57:33

Burnett:

I think there are large swathes of the population in the United States who have, because of their lack of human capital investment, let's say, just their position in the economy, they haven't been able to take advantage of education and so on. They haven't seen any gains, real gains while the rest of the economy has grown. And so that's this vulnerable population that comprises the populist appeal on both ends, right? And so in terms of good economics—

06-00:58:22

Harberger:

Exacerbated by the fact that the data that people use to report this are incomplete. And most of the data on the stagnancy of real wages deal with the pure wage. And that, at the worst, is accounted for per worker, okay? So we have at least two key features that tend to be overlooked. One is the difference between the worker and the household, that we've had a huge rise in the participation of women in the labor force over the years and so while the per-worker income may have remained constant, per-household income has been able to grow. Then the next thing is these things are before-tax wages and not after-tax income. The after-tax income subtracts the taxes and adds the benefits that different households receive from public programs, in particular. And when you calculate that you have a significant rise, particularly at the bottom end of the scale. It annoys the hell out of me that these facts have been given so little publicity. I think that ought to be shouted from the rooftops. And those are the pictures that are most relevant. They are the ones that ought to be engraved in people's heads as you head into an election.

06-01:00:24

Burnett:

So thinking clearly about policy in terms of numbers and a complete picture of the conversation, for example, about raising the minimum wage. When Elizabeth Warren makes the case for it she talks about the productivity gains in the economy and in the wage gains in the economy.

06-01:00:51

Harberger:

It doesn't matter. The productivity that she's talking about is average productivity, is output over labor. Okay. So what happens if labor was working with one machine and then is now working with three machines? Productivity is going to go up. But that doesn't make labor any more scarce and that doesn't cause a justification for labor to get more. That capital cost money and it deserves, so to speak, its rate of return. No, working with average productivity is an ancient, ancient practice. The rough figures in the right hands, where people understand the nuances, they can be handy. But, boy, the idea that when you have this driver and he's driving a two-ton truck and now he drives a five-ton truck, so he should be paid more. No, there's a labor market, son. [laughter]

06-01:02:33

Burnett:

Real exchange rate economics, just to bring it back, that economists began to understand this more and more with all of these kinds of surprises and puzzles. Real-world puzzles that needed an explanation and the conventional macroeconomic understanding was insufficient to explain it.

06-01:02:57

Harberger:

Yes. But you are saying economists and I'm saying a few economists, but by no means that profession as a whole.

06-01:03:02

Burnett:

Okay. So it's not a generally—

06-01:03:05

Harberger:

In Russia, I was for years fighting, fighting, fighting to explain to people the difference between the nominal exchange rate and the real exchange rate. Around the world it's the same thing. Here in the American press the same thing. The onset of real exchange rate economics in the literature, I'd say, is at the earliest the sixties and the seventies. But it's mainly those people who focus on international trade and study these things who have absorbed this aspect. For many very smart economists, these drops of wisdom haven't found their way into their heads. Doesn't stop them from being smart in all the other ways.

06-01:04:18

Burnett:

So in Russia they were saying in the 2000s, "Look, we've got this roughly fixed exchange rate. However we're doing it, we're doing it. We're getting a roughly fixed twenty-eight rubles to the dollar. How come we've got this explosive inflation?"

06-01:04:43

Harberger:

This inflation, yeah.

06-01:04:43

Burnett:

And it's a mystery to them.

06-01:04:44

Harberger:

See, a standard inflation is usually financed by a budget deficit, printing money to finance the budget deficit and so on. Russia had a huge surplus so there's nothing there. The inflation usually involves a deficit in your foreign trade. Here they had a surplus in foreign trade. Everything is on its head in this Russia paper that I wrote. Well, I started by saying I don't like to call this tripling of the price level inflation but I understand you might have to call it inflation because other people think of it as inflation. Let's say we have inflation type A and inflation type B, like hepatitis, and think of this one, this inflation type B, and having very different attributes and very different implications for policy than inflation type A. That's the big story, that you can't be thinking of treating these two inflations the same way.

06-01:06:05

Burnett:

So if you wanted to solve the Russian problem of the tripling of inflation, you wanted to convert it, let's say, into a Chinese case where you had high savings, could you then just absorb—you're going to be conversing with a policy novice here — but you sort of make some claim that you could absorb the inflation to respect the real exchange rate.

06-01:06:39

Harberger:

I don't think it would be easy to do. What they might have done, and actually did do for a bit—you see, the nominal exchange rate, twenty-eight, went up and then went down and finally then came up again. When it was down, that was a case where part of the shock was being absorbed by the nominal

exchange rate, so that the price level rise was more moderate. And I think they in a sense did do part of that. But I wouldn't fault them for having—

06-01:07:35

Burnett: No, it's complex.

06-01:07:35

Harberger: —ended up at twenty-eight after all those years. And the thing that we say in textbooks is that, well, it really doesn't matter if you have a fixed or flexible rate because if you have a flexible rate the flexible rate is going to do the equilibrating and if you don't have a flexible rate the price level is going to do the equilibrating. Well, the thing is that the price level doing the equilibrating, mainly the non-tradable price level doing the equilibrating, has its pains but the pains come mainly when it has to go down. So when you have a fixed exchange rate and you have a need for real exchange rate adjustment and that need calls for the price level to go up, it does go up most of the time. And hundreds of examples around the world, it's when it's pushed down that you get in trouble. That's when you get a Greece, you get Italy, you get Spain, Portugal, Ireland, Argentina in the nineties, Chile and all those countries in the debt crisis time. That downward pressure is horrible.

06-01:09:07

Burnett: And I suppose it could be different groups in Russia in that case that benefit differently. So if people are not importing, for example, and they're working in the non-tradable world, they're in a low-level service sector, they're feeling the pinch. But others benefit in the sense that imports are relatively cheap, right, because of the fixed rate and the ruble is fixed. And in the literature, and maybe you can clarify this for me, real exchange rate comes up in some of your examples of good policy. I'm wondering if this is after the fact. So one of the things you talked about was in Chile the policy undertaken there was respectful of the real exchange rate. Were they aware of that at the time?

06-01:10:08

Harberger: Well, no. I mentioned in many places that it is possible for a country to target the real exchange rate. But you cannot target the real exchange rate with a nominal instrument. You have to have a real instrument to deal with it. And in the case of Brazil, during the Brazilian Miracle, their main instrument was peeling off trade restrictions. They started with a lot of tariffs, prohibitions, quotas, this, that, and the other thing. And they set the nominal rate so as to give them the real rate that they wanted, but that would give them trouble as they were accumulating a lot of reserves with the rate there. So to get rid of the reserves they loosened trade restrictions so that reserves would go back out again via newly stimulated imports. And that worked nicely in Brazil during the early seventies. And the Chileans had this system whereby, in the late eighties, they had this bank debt. It wasn't central bank debt. It was private Chilean banks had caused the debt crisis in Chile. Their debt was in New York and it was selling for fifty or sixty cents on the dollar. The banks weren't permitted to buy that back because of the—

06-01:12:07

Burnett:

The write down?

06-01:12:10

Harberger:

—document, the agreement in the loan document prevented that. So what started to happen was all of a sudden some smart speculators would go to New York and buy this debt at fifty cents and then they'd make some deal with the banks that somehow they'd come to the table, split that extra fifty cent profit, and the banks would be free of their debt and the speculators would make a nice bit. And I was there at the time. Juan Andres Fontaine, a relative of Ernesto but not him, he was in the central bank. And they noticed that there was this big demand for dollars at first and they didn't know where it was coming from but they soon found that it was these guys who were buying this bargain debt in New York and bringing it back. And they saw how tempting it was. There was big profit to be made. And the central bank had the power and so they said, "Well, what we're going to do is regulate this operation. And those who want to engage in this operation have to buy a permit for it and we're going to auction off these permits every two weeks." So each two weeks they'd say, "How many more dollars do we want to be demanded in order to meet our real exchange rate target?" "Oh, we need fifty million dollars." "Okay, let's auction off fifty million of these rights." Next time it's seventy-five million we auction off. Next time twenty-five million. But they always hit their target by auctioning off just enough to meet their target and they managed the real exchange rate for about five years that way. Gradually the amount of discounted debt was being eroded and the discount, as that debt gets eroded, the discount gets smaller and smaller. So by the end of that decade, by the time the new democratic government came in, they couldn't do it anymore and they had a problem. They wanted to continue targeting the real exchange rate but they didn't have that lucky instrument to do it with. And in the end they were forced to go to a floating rate.

06-01:14:57

Burnett:

So this was basically between '83 and '90?

06-01:15:01

Harberger:

Eighty-five and '90. Yeah.

06-01:15:03

Burnett:

Eighty-five and '90. Speaking of the real-world economists, they have this intimate knowledge of how this stuff is working with all of these different moving parts and they're able to engage in these clever manipulations. But as you said before with international markets you have to respect which way the wind is blowing, right? So you can't fight against it. But if you can understand the currents properly you can navigate well and they managed to do so in that case.

06-01:15:44

Harberger:

They managed to do so in both those cases.

06-01:15:47

Burnett:

One of the things you were writing about is, again, the importance of project evaluation and that this is important especially, I suppose, in the wake of the debt crisis, getting out from under bad loans and developing capacity in nation states to evaluate projects for which there are loans and developing capacity to evaluate a better or worse project. One of the things you wrote about is the importance of cost-benefit analysis of cost-benefit analysis systems themselves, which I think is interesting. So how does one do that, right, institutionally?

06-01:17:23

Harberger:

Well, it is very tricky in a sense. I don't know. We have been involved in trying to help countries formalize cost-benefit analysis and establish it and so on. And I would say with distinctly mixed results. And why are the mixed results? It's because it's so easy for a cost-benefit analysis to turn into a bunch of pencil pushers filling in forms and they fill in the forms and then somebody puts a stamp on, "approved," and then it just rolls right through. And you can have good, bad, and indifferent projects with all the forms filled and the stamps put and nothing bad being stopped and nothing especially good being especially favored, so to speak. And it takes personality and character on the part of somebody. You need an Ernesto Fontaine or somebody like that to be able to enforce good decision-making and to actually stop things from happening when they're bad. So that's the worst thing.

But when you start, when you think about it, and you're having a system of cost-benefit analysis, what's the truth? How would Harberger do it? Well, you make a first pass. And in this first pass you see, well, this is a pretty good project. Benefits seem to be way better than its cost. Let's dig a little bit more. But no need to put a lot of money in there because the evidence is pretty clear that you need the thing. If the bridge is broken, no vehicle can cross because there's a gaping chasm there and it's a well-run highway, you don't need to go to a lot of work to say, "Come on, get that bridge fixed and get traffic moving again." In general when you have projects that have been stopped in the middle, they're producing no benefit now but you add that little extra to finish the project and you get the big benefit, the full benefit of the project by just adding that extra 15 percent. You don't need to put a lot of money into the analysis to do that. Just be sensible and analyze it the way it is and what is the marginal expense, what is the marginal benefit? Bang, you're winning. Okay.

Now, suppose you got a project that costs \$100,000. You're going to pay \$100,000 to evaluate that project? That's kind of dumb. What do you do with these little projects? Well, you've got to give them a lick and a promise. And when you give them a lick and a promise, guess what, you're going to be making some mistakes. Well, you accept that risk of making those mistakes because it doesn't pay to spend \$100,000 to evaluate the \$100,000 project. And so it goes. Commonsense, decisiveness, not bean-counting attitudes is what you really want in project evaluation. And the toughness to be able to

stand up to very powerful forces. I don't know in this world of any bad project that was ever done without some powerful force behind it. So if you're going to stop a bad project from being down you have to face down that powerful force.

06-01:22:06

Burnett:

Right, right. Well, I guess that points to the institutional problem. The closer this is to politics, as you've mentioned in your writings, when someone is getting a project for his or her district, then there's powerful incentive to greenlight it.

06-01:22:27

Harberger:

Well, look at ethanol in the United States. That's the most recent scandal.

06-01:22:32

Burnett:

Corn lobby. Yeah, so there is that. Is there an institutional solution or has that ever been established in a country that you—

06-01:22:49

Harberger:

We have the budget bureau, the Government Accountability Office. And they have standards of cost-benefit analysis and they have people that do that sort of thing. And they do a stop project sometimes and modify projects at other times. What do they have going for them? I insist very little but professionalism. When you're fighting these interests who want the road built this way because it's near the governor's mansion or who want the ethanol because the farmers are going to be real happy, in spite of the fact that the environmental consequences of ethanol are virtually nil or negative. [laughter]

06-01:24:01

Burnett:

Well, yeah. I think that perhaps at a political level, like courting a patron, right? So getting someone on your side, or are there instances that you've witnessed in developing countries, US aside, in developing countries where they have developed an independent audit function for project evaluation? In other words, they're protected and their evaluation is given some kind of institutional protection in the political system?

06-01:24:40

Harberger:

Wherever we have a well-functioning system, that's basically what it is. And Canada's pretty good at that and Chile is extremely good at that for a country at its level. They have a history going back now to '74, let's say. They've held up projects. They have nixed projects. They have many times greatly modified projects in the process of evaluating them and trying to make benefits greater than costs.

06-01:25:38

Burnett:

Well, we've talked about your time in the 1990s a fair bit and I want to leave some time in our following session for some other topics. So in 2004, 2005 USAID asked you to write a report and it was called "On the Process of Growth and Economic Policy in Developing Countries." And it is a review of

something that we started talking about last session, which was the fifty years of the growth literature. What is the residual r and what accounts for it? In many ways it's about managing expectations. So my interpretation of the timing of this is you have this advocacy of trade liberalization and this Washington Consensus and a number of countries have adopted this. A critical literature emerges that says, "Look at this liberalization. And they said it was going to provide all of this growth, and that growth, it started, it'd give you a spurt of growth, and then it stagnated, so therefore now we've shown that this liberalization is bankrupt." And in many ways this paper seems like a kind of response to that, where you talk about the nature of growth. This is almost like Walt Whitman Rostow's *Stages of Economic Growth*. It was a *non-communist* manifesto. He gave us a western capitalist version of a stage theory — that you go to this level and then you go to this level, and at a certain point there's a takeoff and it [results in] self-sustaining high rates of growth. And this seems like an answer or a caution, that we now know more about the nuances of growth. Can you talk a little bit about that process of thinking about growth?

06-01:28:01

Harberger:

Well, okay. That paper came at the behest of people in USAID and I'm not sure that the people who asked me really had a very clear objective. But they wanted something on growth and they got something on growth so that was that. And what I emphasize there is, first of all, the absolute truth, that from a world point of view is that the latest twenty-five years is the best in the history of the world. You can really back that up with the huge reductions in poverty as have taken place in China and other places, in East Asia, Vietnam, India. The people of the world are much healthier, much less infant mortality, much longer longevity, much better diet. Go on and on. We should be very happy. In the process of this growth there is no doubt that the big growths have taken place in countries that have been moving toward market orientation and not away from market orientation. And so do not mock the Washington Consensus when you look at things from a worldwide point of view.

Now from the growth itself we have these sort of standard elements. The labor contribution, the capital contribution, and that of real cost reduction. And my paper goes into great detail trying to distinguish between those three contributions. The growth country by country throughout the world. And what happens there is that when you analyze what are the big differences between high-growth countries and low-growth countries, are they different because of the labor contribution, the capital contribution, or the real-cost-reduction contribution? Overwhelmingly it's the real-cost-reduction contribution. That is the key. Moreover, from the best evidence we have, that real-cost-reduction contribution is not easily predictable. It is not something that, because you have it this year, you're going to have it next year. There may be a little bit of that because some big innovation is taking a certain amount of time to filter itself through but certainly in the long run it is not a big thing. What is true also is that countries that are way behind in the scheme have a chance to win

by catching up. And therefore you get big spurts of growth and real cost reduction coming from poor countries that were poorly organized and somehow get to see the light. You don't get those things in the advanced countries that are right at the margin of modern progress. So I think I had a criterion of a successful growth episode which I think was something like 4 percent growth over a period of four years, et cetera. And I don't think that either the US or the UK qualified with any such growth episode in the period that I was analyzing, in spite of the fact that they were at the head of the pack. They had nobody to copy. They had to invent everything new, so to speak, and that made it harder for them. I think that's an absolute truth. It's well known. I think my paper, which is not supposed to be original research in the scientific sense, but I think it tries to put in an easily digestible form these insights from experience. What can you really expect and how can you think about growth and so on? I'd say the real kicker in this is the labor contribution. The thing is that the labor contribution hardly ever makes any big dent, even when it includes human capital.

06-01:34:03

Burnett:

For different reasons, though, I guess.

06-01:34:07

Harberger:

We had two great economists. Bob Lucas tried to make models of growth in which human capital was everything, you see, the big driving force. And Paul Romer tried to make one where economies of scale were the big driving force. Well, the human capital is part of it and the other is part of it. But it's only a modest part in each case. You can't make a whole model that way and you don't understand the world if you try to make a model that way. What about human capital? Well, you think of human capital as being generated by education. So you have somebody who is getting an engineering degree or a PhD in something and so on. And he has this human capital. And he or she is going to be bringing this human capital to bear over what? A lifetime from twenty to seventy, a fifty-year lifetime. Well, how much are you going to get the first year? How much are you going to get the second? How much are you going to get the third? You see? Let's say we can measure by market forces the rate of return. They paid tuition for their education. They also forewent income that they might otherwise have earned, so that both of these are investments in their education. Then what reward do they get at the other end? They get the extra earnings that they make because of their skills. And we measure rates of return of that kind. Sometimes they're 6 percent real, sometimes they're 10 percent real. Maybe even 15 percent real. Spread over this whole lifetime. But you try now to make that a source of a big spurt of growth in a three-year period in a country and you're never going to make it. And as we measure this labor contribution it's the most sluggish goddamn thing you're going to find. It goes up and down a little. And I am not badmouthing investment in education. In fact, I have a joint paper with Sylvia Guillermo in 2014 on the subject measuring the return to education in Mexico. So we're not denying it but we're saying that it is not the leverage factor—

06-01:37:29

Burnett: The driver, yeah.

06-01:37:31

Harberger: —that helps you distinguish between a big growth period and a bad growth period.

06-01:37:34

Burnett: Right, right. It's a yeasty growth as opposed to the mushrooming growth that you find in the spurts. Is that the way you've described that before? Well, what's interesting about this, when you talk about the patterns or lessons of growth, they are spurts and they have a kind of curve to them. There's a transition period where there's higher rates of productivity increases and then there's a leveling off. If you're talking about a permanent change in growth you're talking about continuous additions or changes in productivity.

06-01:38:17

Harberger: Well, the thing is, the thing you're driving at, is that people talk as if a thing that you do today generates permanent growth. And I try to emphasize and emphasize and emphasize, no, that what it does is change the level of things. Well, let's just think about something that adds to the skill of a person. The skill of a person was at this level and now we add to the skill of a person, the skill of a person is at that level. And that extra skill will stay for a long time. Maybe it will deteriorate with time as obsolescence of the skill takes place. But certainly it's not going to be an exponential going up, adding 3 percent per year to that person's output. I look in vain to find a good example of the thing that has that kind of a picture. And yet much of the literature seems to talk as if that is the kind of a story you have. And I say, "Well, no, we have these things that generate real cost reductions and one time they're one thing and another time they're another thing. And each time it's moving the level upward. I think that insight is one of the keys to straight thinking about growth.

06-01:40:20

Burnett: So another piece of it in terms of managing expectations, I suppose, is that you explain in your conclusions the cost and the benefits of growth are often unevenly borne or distributed. Because of the unpredictable mushroomy nature of this, that that's something that needs to be understood in the policy world when you're thinking of implementing projects to stimulate growth. You also talked about an interesting piece on accounting for public infrastructure. I found this really interesting, that public infrastructure is not included in the calculations of gross domestic product. So when you're talking about rates, and this comes in with project evaluation, I suppose, and you argue that the benefits would be captured in real cost reductions to capital and labor that make use of the infrastructure. So, for example, a public highway. What was the target of that analysis when you were talking about public infrastructure in this conversation about policy?

06-01:41:58

Harberger:

Well, as I remember, what we were trying to do is to look at the growth of a country. And where I was headed in that paper was trying to measure rates of return to capital. And we start with the GDP and we divide the GDP into the piece that goes to labor and a piece that goes to capital. So we've got this piece that goes to capital. And then we try to measure the capital stock. And the best way we measure the capital stock is to take the investment of each year and cumulate it, allow it to deteriorate with time through depreciation. So we depreciate the old capital and we add the new and we build up the capital stock that way, all in real terms. So we have this real capital stock and we have this real return. We put the real return on top of the real capital stock and we have some kind of a rate of return. Now, that rate of return, the way it's measured, we have to take off depreciation because it's not part of a net return. We know how to do that. Well, coming to your point, here in the base we have Fort Leavenworth and we have Camp Ellis, Illinois, and we have the new museum that's being put up on the mall for black history and so on. And that's part of the capital, right? But it's not part of the capital that's rendering that return. So what we do is we sequester that capital and say, "Well, now we're going to get the capital that's earning the rate of return," and then we have this capital that's earning the rate of return and we compare it with the return. Then we look at it again and we say, "You know, that capital stock has a huge amount of housing in it." The rate of return on housing is not that awfully high. Mortgage rates keep it down and people build and so on. So if housing is only earning a 6 percent rate we're going to take that 6 percent on housing out of the numerator and we're going to take the housing out of the denominator. Now we have the remunerable capital at the bottom and we have this other thing. We get pretty damn big rates of return. And that comes as something of a surprise to people. But it's there in the data and it's very, very hard for anybody to gainsay it.

06-01:45:35

Burnett:

But are there cases, because you also write that twenty to forty percent of investment in developing countries is public investment and out of that—

06-01:45:44

Harberger:

Well, "public," you have to be careful. There is public and there is infrastructure and I want to distinguish between the two. And maybe infrastructure isn't the right word. When Mexico invests in Pemex, Pemex might be ill-managed and crapped up with politics and stuff, but it's basically an enterprise. And I would mix it with the private enterprises in that sense. But when they build a civic center, that's a different thing. That civic center isn't yielding any money at all and whatever benefit it has we're not measuring it. So I'm going to put that out of base when I try to measure the rate of return to remunerated capital.

06-01:46:44

Burnett:

So this paper, when it's published as a report, this begins a new period for the last half of that decade where you were made chief economic advisor at

USAID. Can you talk about that role and what that meant? Thinking about your career at USAID, I think of you as being a chief economic advisor for much longer than that period but I guess they just gave you that title at that point.

06-01:47:17

Harberger:

Well, no. My first work with AID was really my Chile project starting in '55, '56. And I was never very far from AID all the way through. And the role as chief economic advisor came because certain key economists, Jim Fox and Juan Belt were two of the promoters of this. Anyway in the nineties AID had paid a lot of attention to economics and they had economists in key countries and they were pushing good economic policy reform and things like that. And they had maybe seventy-five to a hundred people called economists. By the time I came onboard as chief economic advisor they had about twenty-five. And this was thought of as a tragedy by these economist people. And part of the hope was that I, with my presence, would be able to drum up more interest in this story.

So what did I do? For me I loved the job because it gave me adventures. Two, three times a year I would go to some new place, Sri Lanka, Azerbaijan, Ethiopia, Ghana, not to mention Latin American countries where mostly I had been before. But in any case I was just gleeful at being able to get around and see these places and make some little dent in something or other. It couldn't do much. These visits to other countries rarely exceeded two weeks. I insisted on two weeks, by the way.

06-01:50:06

Burnett:

They wanted it to be shorter?

06-01:50:07

Harberger:

Well, it would have been shorter in many cases had it not been for my insistence, yes. And so that was pretty good. And I was pushing economists and I was pushing cost-benefit analysis and stuff like that. And gradually the number of economists did indeed grow and got up to maybe seventy, seventy-five again before I was done. I don't know how much of that was due to my presence and how much was due just to what was going on upstairs. I don't have a very great opinion of AID as an organization. We lived in the Reagan Building, which is a huge, huge whole block of a building in Washington, DC. And I had a handler who took me around, Bob Aten, and I would be with my canes walking. I figured my average day when I was in that building I walked two, three miles going from one office to another to visit these guys or those guys or those guys. And I kept wondering what the hell are all these people doing in Washington and why aren't they out there in the field where they ought to be? And it seemed layer upon layer of bureaucracy and so on. I couldn't see much merit. Yet I am a bit of an enthusiast about AID and why? It's because I believe every now and then they do a project that's a crown jewel. And that covers a multitude of inefficiency and bureaucracy and sins of other kinds. And when I go out in the field most of the time I find the people

are dedicated, alive, interested, mixing in with the locals, as it should be. And I just wonder how that heavy bureaucracy got built up in Washington and what the hell it is doing. Is there real genuine product?

06-01:53:15

Burnett: Well, when you said twenty-five economists when you signed on in 2006 it's very surprising to me. I would have imagined a lot more economists at USAID than that.

06-01:53:29

Harberger: Well, these are people labeled economists.

06-01:53:31

Burnett: Okay, so there are people with economics training. But also it's got a kind of a foreign service element to it?

06-01:53:39

Harberger: It was a thing. The part of the story that we looked a little bit askance at is kind of the NGO people. The NGO people go to a country and say, "Well, we have to work on this problem. The women."

06-01:54:19

Burnett: Water.

06-01:54:20

Harberger: The education of the children, the this, the that. And what is happening there is that however laudable are their motives, they're in a way trying to bring modern American values into Azerbaijan and that's a hard task and it gets you in trouble more than it helps you. That's kind of the story. And the idea, the more old-fashioned idea, Rudyard Kipling idea—get mixed up in this Hinduism and find out what it's all about—to me rings truer than let's bring these people up to our standard and have them share our values in each and every way. But that's just my cantankerous view of things.

06-01:55:35

Burnett: [laughter] Well, you've always talked about your approach. A lot of it has to do with listening. And you go in and you listen and you learn and you're not the instant expert. This idea of a consensus of values about what modernity is or what trajectory a country should go through then comes from the center, whether it's the United States or the United Nations and it goes out and it says, "This is what you need to do to be modern." You can't imagine that that develops a lot of buy-in from—

06-01:56:20

Harberger: Yeah. Putin kicked AID out of Russia mainly because of these NGOs. He didn't do it because of our economic advice or anything like that. But these NGOs were trying to change Russian culture.

06-01:56:42

Burnett: Yeah, well, LGBT rights haven't fared very well in Russia, for example.

06-01:56:48

Harberger:

No. And the question is can you be thoughtful about these matters as distinct from being utterly proselytizing about them? And that's a subtle difference and I believe that the NGO story is motivated by US home politics more than by any deep thought by AID people that this is really the way to proceed with our foreign aid.

06-01:57:37

Burnett:

So it's a mixed bag of results depending on the approach one takes. Well, let's take a break for now and we'll come back in the afternoon.

06-01:57:50

Harberger:

Okay.

Session 6B, Afternoon

06-01:57:52

Burnett:

This is Paul Burnett interviewing Dr. Arnold Harberger for the Economist Life Stories Project and it's the afternoon session of session six on March 2, 2016 and we're here in Los Angeles, California, talking about the recent past now, the late two thousands. One of the things that was also in evidence in the late two thousands, in addition to the critical literature of development, international financial institutions, critics who see the trade liberalization as a political move, right? On the other side you have a critical literature emerging by figures such as William Easterly and Dambisa Moyo. Easterly wrote *The White Man's Burden*, basically arguing that a lot of aid did more harm than good or didn't do any good at all and that what's needed is—I think he calls them “seekers” but I think he really means entrepreneurs — that paving the way for entrepreneurship is the way forward. Dambisa Moyo has a similar critique and I think Dambisa Moyo is more focused on Africa. Says that the way forward is to really get the development folks out of the way and allow foreign investment to solve Africa's problems. So do you have any reflections on that side of the literature?

06-01:59:48

Harberger:

Well, I would say the following. Obviously if you can overcome all sorts of traditional taboos and things like that, which fifty, a hundred years ago, you could have had a China like you have now. You could have had India like it is now instead of like it was then. What was in the way was the whole overlay of thousand-year-long histories and cultures and caste divisions and educational prejudices and rites that had no positive function and often got in the way of things. And over time these things have tended to be overcome and I think in many places which are still backward, that's a part of the explanation. But one has to be able to overcome those things and one doesn't do that by forcing it from the outside but by somehow allowing the juices to ferment inside that generate change. And I'm very optimistic about the world in that regard.

06-02:01:42

Burnett:

Do you think that there's, in some of the civil-society pushes, that there's too much effort to force change and that can erode trust in international institutions?

06-02:02:02

Harberger:

Well, ideally we would like that this evolution grow from within. I think that the evolution growing from within comes considerably better when the sons who have education abroad come back and insinuate things like that than when schoolmarms from Sweden come and tell you what to think and do. [laughter]

06-02:02:51

Burnett:

And you've had some experience with that in your travels and in your roles, various roles with organizations. We've talked about this a number of times over the last several sessions. Your metaphors for the nature of economics work, they're so rich and I wonder if you can just reflect on a number of them. You're a big fan of biological versus mechanical.

06-02:03:24

Harberger:

Biological analogies, yes. Absolutely.

06-02:03:26

Burnett:

Yeah, biological analogies. And so thinking about economies as more organic.

06-02:03:32

Harberger:

Exactly.

06-02:03:36

Burnett:

Policy advisors are like the pilots of a small boat in the ocean.

06-02:03:45

Harberger:

Yes.

06-02:03:45

Burnett:

So the ocean is market forces.

06-02:03:49

Harberger:

The ocean is the world the way it is. You have stormy seas which give you a hell of a lot of trouble and you have to be extremely deft and intuitive and lucky in order to get through. And then you have these beautiful flat seas with a nice wind at your tail and that's a different time.

06-02:04:16

Burnett:

Also when you were talking about developing countries. You're a big advocate of "artful oversimplifications," I think is the phrase that you used.

06-02:04:33

Harberger:

Well, that is simply economics. It's just the sheer fact that when we build models we grossly oversimplify the world, whether we believe we're doing it or not. And I think that there are those who get so enamored of a model and a

way of thinking that they kind of forget that they're dealing with what is necessarily an oversimplification. And being so is always subject to being not quite what you're assuming it to be, you see, and to have that degree of tentativeness and to be to that degree with your eyes open and aware of the chances that this is going to be sort of an odd case, like China. Talk about a country that absorbs that many dollars and prints that much money and doesn't have inflation. Most economists would say, "they have to have price control, they have to"—no, no price control, no nothing. It was just people holding money.

06-02:05:45

Burnett: Right. Propensity. So they're a saving society, as well.

06-02:05:51

Harberger: Yeah. It just happened in the context at that moment. And what it takes is just keep your eyes open, and not be too bound to a preconceived way of viewing things, that you can be looking at it and not see it.

06-02:06:14

Burnett: One of your examples of a not-so-artful oversimplification was the infinite elasticity of supply of credit for—which is assumed in certain models, right—for a developing country.

06-02:06:33

Harberger: Yes.

06-02:06:33

Burnett: And I thought your response to that was very interesting. Do you remember what you said?

06-02:06:38

Harberger: Well, I think tell that to the finance minister who's stuck in a crisis and trying to borrow money abroad. [laughter]

06-02:06:44

Burnett: Right, there you go. But you had an analogy and you said a small country, small developing country is like a resort and it's selling lots and the first lots go at a certain price but the best lots are taken up first. So those are the first lenders. And then after a while the less desirable lots have to be sold at a discount. So you have a lot of these kinds of folksy ways of explaining what can be—they're kind of, I suppose, pearls of wisdom. You're trying to get people to think in commonsense ways about these problems and they get too wrapped up in what they can see as economic laws or economic regularities and so that's been some of your contribution. And the other one that you talk about: policymaking is a patchwork quilt.

06-02:07:55

Harberger: For sure. For sure. How many times in the history of the world has a new government come in and swept away what was there before and replaced it with something genuinely new? I haven't studied the Napoleonic era but I

would say that that has to be the champion of that. So many things changed with Napoleon: the Napoleonic code, the metric system, the this, that, the other thing. And maybe that would be an example of how major change can take place maybe pretty successfully. But by and large you're stuck. Just look at our congress and what they cannot do to rectify things that are already there and known to be wanted to be rectified. [laughter]

06-02:09:07

Burnett:

Well, we can turn to some recent developments. We were talking about this just this morning, I think, about the way in which old ways of thinking, they have a way of coming back. So I'm wondering if you can talk a little bit about how you reacted to the crash in 2007-2008. You did talk about it a little bit yesterday.

06-02:09:39

Harberger:

Well, first of all, it is my firm belief, utterly firm belief, that if our congress and our governments had steadfastly maintained the old prerequisites for borrowing on a mortgage, that you want a 20 percent down payment here or maybe at least a 10 percent down payment there, that that whole crash of the world economy would not have happened. And I have tried this out on many colleagues in different countries and different institutions here. And on the whole they agreed that if it had not been for that—that doesn't mean that there weren't many evil deeds, so to speak, along the way. And the evil deeds, the worst consisted of those mortgage brokers who deal with the borrower and who tell the borrower, "Well, we're going to give you a mortgage with negative depreciation, negative amortization, so you don't have to pay off this mortgage ever." "Why is that?" "Because your house is going to keep on increasing in value and so you just pay the interest and you don't have to pay any amortization," and bang, bang, bang. Well, there are two classes of such people. One are the innocents who really believe that that's going to happen and the others are the ones that ought to be in jail, who know damn well it's not going to happen and nonetheless feed this pap to this poor family who is then placed in misery as a consequence. I really think there ought to be hundreds of those guys in jail.

06-02:12:08

Burnett:

Yeah, yeah. The economy has recovered. Unemployment has gone down. But there's still persistent pockets of misery, as you say, and we're living in an election cycle now with populism on both sides of the spectrum, inching toward the middle. We just had Super Tuesday yesterday, which has confirmed that at least Donald Trump is looking to be the frontrunner. We'll see what happens. And Bernie Sanders is still important in the Democratic nomination process. What can economists do to promote good economics, as you see it, in this time? What needs to be done in order to put good economics back into political discourse?

06-02:13:34

Harberger:

I honestly don't know. Number one, the forward projection of the liabilities for entitlements are just horrifying and we really have to do something about that. And I think the idea of, at least on the retirement side, an automatic creep of the retirement age so that it always remains a given fraction of the life expectancy rather than the life expectancy going up and the retirement age remaining the same, that would be a tremendous plus. And it would trigger later retirements and all the rest of the things just by itself and I think that that is an easy one if the populace will ever let it happen. They always bring up people, oh, there's some occupations they can't work past sixty-five and stuff like that. Well, I don't believe that at all. I believe that you can have people who are physically incapable of doing given jobs at any age and you have people who are very old and capable of doing almost anything. And we have to get around to that in the end. We can't be making arbitrary cutoffs. The issue that there are some people that can't do a job at seventy is no reason to keep the whole retirement age at sixty-five. [laughter]

06-02:15:39

Burnett:

That makes sense. Yes. And so would a host of other policies, too, I suppose, along that line. We were talking off-camera yesterday. We started on this conversation about the "Stigler diet." And this was a task, I think there was a nutrition question around feeding the troops [during World War II] and George Stigler developed a sort of maximum nutrition at minimum cost. And it's this first instance of linear programming. So it's an interesting case.

06-02:16:17

Harberger:

That's right. It was Stigler with his tongue in cheek, as usual, and trying to poke fun at the nutritionists who were saying, "Well, you need this and this diet in order to be good," and it was quite expensive. And so he got all the lists of all of the nutrients and vitamins and everything else and then he got a whole list of foods and the prices of the foods and their content of the vitamins, the fibers, the carbohydrates, proteins, so all of the nutritive content of each item. Then he said, "Well, how can I get, over a year, the full demanded nutritive content of everything, but cheapest?" And he came up with this diet which he plastered in his paper for a few given years. It was an interesting diet and it was goddamn cheap. It was really cheap. I buy my potatoes now. Rarely do I pay more than a dollar for a ten pound bag. I buy two ten pound bags at a time, one for Brentwood and one for Bell Canyon and they last me for a half-a-year. For two bucks.

06-02:17:55

Burnett:

Where do you get a ten-pound bag for a dollar?

06-02:17:59

Harberger:

Oh, in some of our local stores.

06-02:18:02

Burnett:

That's phenomenal.

06-02:18:03

Harberger:

I get the flyers all the time every week and they have sales. Most recently you have to pay a dollar and a half for a ten-pound bag but that's still pretty cheap. [laughter]

06-02:18:19

Burnett:

So long as you've got a root cellar to keep them from sprouting.

06-02:18:26

Harberger:

But anyway, the Stigler diet was such that I remember one year the principle starch, so to speak, was potatoes. So you were eating potatoes, potatoes, potatoes. The next year it was pancake flour. [laughter] And you can see that these were not very appetizing diets. But that's the way it is.

06-02:18:57

Burnett:

This is something, in terms of your values, you have an approach to your food consumption. Do you want to talk about that a little bit?

06-02:19:08

Harberger:

Well, I mean, I have always been a minimalist. When I was a kid I used to have fantasies about me out in the wilderness taking care of myself and all of that. I remember when I was working in this butcher store-cum-grocery store in high school. I was trying to get my mother to change from sirloin steak to cubed steak because the cubed steak had as much nutrition as the sirloin steak and was cheaper and didn't have any fat and all of that. So I've always been on that side of things. So in my bachelor years, since Anita died, I've sort of made it a goal to have my food budget of fifty dollars a week and I live extremely well on fifty dollars a week. I have probably a two-pound bag of shrimp a month at least. I buy three or four pounds of 7-percent-fat chopped sirloin and I make myself beautiful hamburgers with it and they last a long time. And I buy chicken breasts, boneless, skinless chicken breast in the big family tray. I cook the whole lot immediately when I get home and I wrap the individual breasts in little bags and put some in the freezer and some in the refrigerator. The ones in the refrigerator get eaten in the next few days and the ones in the freezer come out as need be. My typical breakfast is bran flakes with cranberry juice — not milk — cranberry juice, and raspberries on top. But I buy my raspberries ideally from Ralph's because Ralph's every year seems to have days when they're selling these clamshells of raspberries for ninety-nine cents for a six-ounce clamshell. And last year I bought about eighty of those and froze them all. This year I bought about fifty-six, I think. But they're going slowly. I'm going to have leftover amounts of raspberries, partly maybe because of living here with Carl for as long as I did, that the raspberries stored in my refrigerators in Bell Canyon and Brentwood were idle during that period. But anyway, I have good food there. I buy eggs and make semi-omelets of eggs and bacon and onions and tomatoes and cheese. God. I can't imagine that my diet is in any way inferior to what people are eating in the best restaurants, in the best hotels.

06-02:22:56

Burnett:

So you realize that there's quite a food politics movement that's been going on for a long time. There's a slow food movement coming out of Italy, that we've lost touch with how we eat and where our food comes from and so there is a movement towards organic this and that and local food production and food sourcing and all of this stuff costs, unless you're growing it yourself, a lot of it costs a lot more than certainly fifty dollars a week. So is this the Chicago-School answer to the slow-food—

06-02:23:40

Harberger:

What they say, and I believe, is that both frozen green beans and canned green beans and frozen broccoli, in particular, are actually better than the fresh stuff that you buy and you leave in your refrigerator for a week and by that time they're not as good as what's in the can or in the frozen pack. And I know that from experience. I see the broccoli go brown.

06-02:24:24

Burnett:

Right, right. So there are these adaptations to modern life. But the point of all of this it that, it is kind of an experiment for you but this is also kind of how you approach things. You live a fairly simple life.

06-02:24:43

Harberger:

Real cost reduction is the key to growth, right, is in some sense the key to economics. It's the dynamic element in economics. And what's, for a country, the greatest and most painless real cost reduction is when the price of oil goes down from a hundred dollars a barrel to thirty dollars a barrel. The importing countries have that full extra seventy bucks to spend on anything else they want. And that is real cost reduction. That is a way in which economic growth makes itself felt. And you and I can do this if we find in the ninety-nine cent store something that we pay four dollars for at a different place. We have made a real cost reduction and especially if it's just as good, which it often is.

06-02:25:53

Burnett:

Right. Well, at the turn of the twentieth century, Americans spent over half their income on food, and about 10 percent on rent or real estate or whatever. And now we spend around 7 percent of our income on food and I don't want to think about how much we spend on rent and real estate and the other things, right? But as far as food is concerned—

06-02:26:21

Harberger:

Well, does that include restaurant meals? I'm not sure it does.

06-02:26:26

Burnett:

No. No. That's definitely a whole other thing. And a lot of the expense for the poor, of people working two jobs, they're grabbing a fast-food meal in between jobs and they're not reaping the benefits of that type of economy. At any rate, I'm glad that we talked about that on camera because I think it's an interesting facet of your way of being in the world.

- 06-02:27:11
Harberger: Yeah. Well, T.W. Schultz was a frugal person.
- 06-02:27:15
Burnett: I bet he was.
- 06-02:27:15
Harberger: D. Gale Johnson was a frugal person.
- 06-02:27:17
Burnett: I bet they were.
- 06-02:27:18
Harberger: And Al Harberger is a frugal person. [laughter] That we were three chairmen of the department of economics may have something to do with that or may not. [laughter]
- 06-02:27:39
Burnett: And those folks are no longer with us. I think T.W. passed in '98. Is that right?
- 06-02:27:46
Harberger: Something like that. D. Gale in the early two thousands.
- 06-02:27:51
Burnett: Yeah. And you wrote a nice piece on him and his contributions to the profession. So one of the things we haven't talked about for a long time is tracking family. I think the last time we talked about family they were playing in the pool in Panama somewhere. So can you fill us in on what's happened in the intervening years?
- 06-02:28:27
Harberger: Oh, my goodness. As I said earlier, the kids went with us as much as possible. They have great experiences from India, from Taiwan, from Colombia, from Chile, from Brazil especially, Argentina, Uruguay. They have memories of all of these places. Mexico. And this was a great contribution to their education and to our family life. It kept us very much united as a family since we would do things together. Maybe when kids are with the family in a strange place they gravitate more to their parents than they would when they're running around in the neighborhood with their neighborhood friends. So this closeness is there. Certainly that has prevailed all the way through and here I am now in my old age. My house in Bell Canyon needs big repairs. Suppose I were alone and discovered this thing and the water leaking in and the boards needing to be replaced and this and that and the other thing, and I having to find people to do this and not necessarily trusting them and not trusting my own judgment. Carl, he's the manager. I don't worry a thing about it. I'm going out today to look at it for the first time with Carl just so that I have seen it before he takes over with Santos to fix the thing. I never take my car to be repaired. Paul takes my car to be repaired by a car repair person that he trusts very much, and has four cars of his own. So he is a very good customer, let's put it this way, of

George. And George is very fair and a super diagnostician and never charges you for something he didn't do. Never asks to do something that doesn't really need to be done. Just the ideal person. Paul, the intermediary. I just say, "Paul," and the thing is done. He takes me to the airport. He brings me from the airport. It's just so comfortable to be in old age in a circumstance like that. When I had my difficulty, I slept here at Carl's house for nearly two months and everything was perfect. That I am not beset by worries and covered with wrinkles comes in part from that. [laughter]

06-02:31:57

Burnett:

Well, you mentioned allowing the indexing the retirement age to the increasing cost of the social security system. Here you are, you're ninety—

06-02:32:16

Harberger:

Ninety-one now.

06-02:32:19

Burnett:

Ninety-one, going to be ninety-two, and you're working constantly. You're still working. You're basically not retired. You're officially retired from UCLA at 2014 or beginning—

06-02:32:38

Harberger:

At the end of 2014, yeah.

06-02:32:43

Burnett:

Yeah.

06-02:32:44

Harberger:

At age ninety.

06-02:32:48

Burnett:

How many consulting or business trips did you take in 2015?

06-02:32:54

Harberger:

Oh, it wasn't that many. I was to teach two mini courses in Clemson, one in spring and one in the fall. And I, each year for many years, have been going to Glenn Jenkins' cost-benefit program in Canada and that takes about a month in the summertime. And we have a conference in Mexico every February in Alamos that I go to. In March I go to the cost-benefit meetings in Washington. Last year I went in June to Chile and then after Canada I went to Argentina for a couple of weeks. And then there was the Mont Pelerin meeting in Lima where I had a presentation to make. And then I got my hip broken and that was the year—

06-02:34:16

Burnett:

Holding court with the people from the World Bank and the IMF in the process. So that's retirement, in other words.

06-02:34:27

Harberger:

That's retirement, yeah.

06-02:34:27

Burnett:

Okay, just wanted to clarify that. Glenn Jenkins wrote about this cost-benefit course that you do at Queens University. The course followed him but for sixteen years he says you never missed a course at Harvard. You came every year.

06-02:34:54

Harberger:

I've come every year both places. Never missed any one. He missed one but I didn't. Over thirty years now.

06-02:35:05

Burnett:

So the point of that, and I think the point he was making, is your generosity. So much of this is so beyond what is in your job description. Someone asks you to do it and you do it because it helps people.

06-02:35:28

Harberger:

Well, I'm a part of it. I am not that famous that I am bothered everyday by, "Won't you do this? Won't you do that? Won't you do the other thing?" But I have enough background that there are these things that become great traditions. Like the Alamos conference and the Glenn Jenkins course and now the Ernesto Fontaine course in Chile in the Catholic University. Now the cost-benefit analysis meetings in Washington. And the new courses in Clemson. You see, all of these things are things that I become a part of, and I take pleasure in that and it isn't, as I say, that I'm so pelted with invitations to do other things that I'm always just sort of chopping myself off, which people who are super famous, they have that problem. They have to kind of hide from the public and all of that.

06-02:36:57

Burnett:

There's a couple of strands I want to continue talking about. But we should talk about the Society for Cost Benefit Analysis. Can you talk about the genesis of this?

06-02:37:12

Harberger:

Yeah, okay. Benefit-cost analysis.

06-02:37:13

Burnett:

Benefit-cost—

06-02:37:14

Harberger:

They say. We always called it cost-benefit but—

06-02:37:17

Burnett:

Is there a reason why they reversed it?

06-02:37:18

Harberger:

Well, they like benefits to come first. So this came because of a guy named Dick Zerbe, who is up at the University of Washington in Seattle and has been an ardent fan of cost-benefit analysis and practitioner for a long time. He hasn't deeply contributed to the literature of the subject but he certainly has

been a continuing operative in the field. One of the things he did out of Seattle was starting maybe around 2004 or '05, something like that, he had an annual conference there where he pulled together cost-benefit people from Washington, from other universities and so on, and we've had maybe twenty, twenty-five people in a conference there every year. Well, at one juncture the thought popped up, "Why don't we form a society?" And out of that arose this Society for Benefit-Cost Analysis, of which I was the first president and Zerbe was the second and Glenn Jenkins was the third. And so it goes. And that has been meeting in Washington all the time, getting support from the MacArthur Foundation for most of its life. And I think it has thrived and it has become significant. It has a journal that is of serious significance in its field, the best one in the United States of its kind certainly.

06-02:39:27

Burnett:

And about how many members are there now in total? Roughly?

06-02:39:29

Harberger:

Oh, I don't know. It's in the hundreds.

06-02:39:32

Burnett:

Right, right. Well, it's a new association so it'll take time to build up. So that's since 2008, right?

06-02:39:40

Harberger:

That's about when the actual first meeting took place. My session, when I was president, was around that time, yeah.

06-02:39:53

Burnett:

So you've been recognized. Last session we talked about the National Academy of Sciences election. But you've also received a number of prizes from a different number of associations. Can you talk about some of the ones that are most meaningful to you?

06-02:40:16

Harberger:

Well, certainly NAS is the most meaningful thing and the second is being president of the American Economic Association, both of which are the result of being so chosen by my peers, so to speak. It's not some outside thing. I'd say next I have six honorary degrees but three of them are sort of not particularly significant. They come from minor universities and they were just happy to sort of throw that in somewhere along the line. But the Catholic University of Chile and the University of Tucumán in Argentina and the ITAM in Mexico are certainly three of the absolutely top places in economics in Latin America. And to have those honorary degrees is very significant. The most elegant ceremony there was the one in ITAM where David Rockefeller and the guy who was president of the Central Bank of Mexico for many years and myself were the three honorees. And that was a big performance. I had an honorary professorship at the university UPAEP, I think it's called, in Peru, that also made a big splash. It was like an honorary degree but it was an honorary professorship instead of an honorary degree and that was a

significant thing from a significant place. Then I was happy to get an award from the University of Chile during the time of democracy in Chile because of the situation of the identification of me with the military government sometimes and so on and it was nice for this rival university to give me this award. I was happy with that.

06-02:43:07

Burnett:

Was that association made in Chile or is that more a function of people in the States and Andre Gunder Frank, who made those claims in the States, in the American press and in the UK press?

06-02:43:24

Harberger:

I have never encountered this type of problem in Chile. There's a film that just came out that I just saw for the first time in Alamos this year, that Carola Fuentes was the person who did it.² Was she trying to emulate what's her name—

06-02:44:03

Burnett:

Klein?

06-02:44:07

Harberger:

You mentioned her name before.

06-02:44:09

Burnett:

Naomi Klein?

06-02:44:09

Harberger:

Naomi Klein, yeah. It's a funny thing. It traces the Chicago Boys from studying in Chicago and implanting their ideas in Chile and me being down there and all this kind of thing. She was a good journalist. She worked for CNN in Chile at the time when we started and she promised that she would faithfully represent us. And looking at this thing and the quotes from me and De Castro, Fontaine, and Luders, Donoso and so on, and some of the people who were on the other side, like [Ricardo] Ffrench-Davis and [Carlos] Massad, who were former students, who were alienated from the military government. I thought that she accurately represented all these people and their feelings and all of that and if you just took those parts of the film it would be a grand encomium of our project and what we had done and all of that. But interspersed with that are clips showing Pinochet's police during something or other in the middle and toward the end there are sort of the occupy riots as of 2011. And they're just sort of stuck in there. No argument as to what this has to do with us or anything like that. Some people are annoyed with that but I think if you look at just what was said about us, it's not lying about us.

² *Chicago Boys*, Carola Fuentes, Rafael Valdeavellano (2015; Chile; CNTV, Corfo/ distribution, Icarus Films).

06-02:46:35

Burnett:

Right, right. But the semiotics of the documentary is such. I think that's probably going to be the fate for a while at least of that story. It's just the way it ends up being reproduced in that narrative.

06-02:46:52

Harberger:

Have you seen by any chance *The Chicago Boys*?

06-02:46:47

Burnett:

No, I haven't seen this documentary. It's in Spanish?

06-02:47:00

Harberger:

Well, it's in Spanish and English to a degree. It has some subtitles and stuff and it won some sort of a Sundance award here.

06-02:47:13

Burnett:

I want to continue talking about awards and accolades in a moment. Certainly your influence, especially in Latin America, was really felt and celebrated. Can we turn it the other way, and say, so, the Chicago school of good economics went out to Latin America and established this good economics there. We talked a little bit about this. But this circulation back, what you got from those bright students, what you got from the interaction with them, what came back to Chicago from Chile? What came back from Sergio De Castro, from Fontaine?

06-02:48:06

Harberger:

Well, you have to ask them somehow. They're right now in Chicago in a big sort of effort to celebrate the relationship. It has to do with the history of the department and all of that. Alvaro Saieh, who is the principal donor for Saieh Hall of Economics, which is the new economics building at Chicago. So his name will be for a hundred years there and that is the locus of the Becker Friedman Institute and of the department of economics. And they are going through a number of reprise items connected with our linkage to Latin America. I was just reminded that in Santiago some years back they had done a sort of a festschrift honoring me and I think that came out as a tome of what was then *Cuadernos de Economia*, which was their publication. And Francisco Rosende just wrote me the other day saying that he had been told that they were going to translate that into English in Chicago as part of this kind of celebration.

06-02:50:12

Burnett:

You have talked about the ways in which, in the Johnson open-economy macro stuff, the students there asking those questions that got people thinking and got you thinking about open-economy macro. And so there's just the circulation of ideas over a long run as a result of these relationships. You seem to have tremendous respect for the intellects of these folks.

06-02:50:43

Harberger:

Yeah. Their asking those questions then did not depend on their being Latin Americans, I don't think. It depended on their being students of Mundell and

Johnson. But certainly those who went to Latin America to try to do policy, it's rare that they get less than a B plus. They get As and they get A minuses and they get B pluses and rarely less in what they do. And I think that is just great. The thing that I take such joy in is the following. When I think of myself I think of myself as a student of Friedman, a student of T.W. Schultz, a student of Jacob Marschak. But then I had classes with Lloyd Metzler and with John Nef and with Don Patinkin and with lots of other very significant people. But I had classes with them; I'm not their student. They are not my teachers. You follow me? And what makes me so pleased with my Latin Americans is that so many of them think of themselves as my students. It's not me saying, "They're my students;" it's them saying they're my students. And that is very heartwarming.

06-02:52:42

Burnett:

Well, there's also an element of affection that is not the usual. I don't know. Can you tell me the origin of your nickname?

06-02:52:57

Harberger:

Alito?

06-02:52:59

Burnett:

Yeah.

06-02:52:58

Harberger:

Well, my name is Arnold. People wanted to call me Arnie. I never liked Arnie. We ultimately got to Al. And so I was Al forever. And I get down to Latin America and I'm Alito. [laughter]

06-02:53:16

Burnett:

But this is how they refer to you and it's this combination of respect and affection. Like it's palpable.

06-02:53:28

Harberger:

Yes, that is true.

06-02:53:29

Burnett:

It's a gift in a sense, right?

06-02:53:35

Harberger:

Well, we're a family and we have lived that way.

06-02:53:40

Burnett:

Yeah. And you were recognized officially, as well, [with the] Carlos Diaz-Alejandro Prize. And in 2000 you're awarded this prize and it's from the Latin American and Caribbean Economic Association.

06-02:53:59

Harberger:

Yeah, LACEA. Yeah.

06-02:54:00

Burnett:

LACEA.

06-02:54:01

Harberger:

That was their every-two-years prize that they give, yeah. And they have a distinguished group. Sebastian Edwards got it many years later. Carmen Reinhart whose name you might know also got it.

06-02:54:20

Burnett:

And at UCLA there's a distinguished lecture series [in your name].

06-02:54:24

Harberger:

Yeah, that's a kind of a funny one. [laughter] There was this fellow named Dick Rosecrance who was a political scientist and interested in international affairs and involved in the international affairs element on the eleventh floor. I gravitated into his orbit or he into mine, one way or another, and we schmoozed together quite a bit. And then all of a sudden, quite out of the blue, he told me, "Well, now there was an Arnold C. Harberger distinguished lecture being established." And why he said that had something to do with what was going on in Chile and the nature of Chilean economic growth over that recent time, combined with the increase of savings in Chile, that the idea of saving and the growth deeply impressed him. He somehow had the idea that I had something to do with that and did this. And there was another guy named, I think, Brodie, who was dealing with the defense policy and he made a Brodie lecture. And both of these lectures have gone on now for twenty years, I guess. And the Harberger lecture had George Shultz, Paul Volcker, the head of the Federal Reserve of New York before Geithner, I forget his name. And Bob Mundell came for that. Steve Cheung, Jeff Sachs, Joe Stiglitz, Angus Deaton. It has good draw.

06-02:57:03

Harberger:

And I am honored that that is there with my name on it and I am honored that these people come with willingness and so on. I don't always agree with all of them, but I think it's great.

06-02:57:25

Burnett:

And I think you've answered this question in a number of ways over the last times that we've been talking. Is there a Chicago school or Harberger school of development economics, or of project evaluation? If you choose anything you like? I'm going to preface this by saying I know you're going to resist this kind of definition.

06-02:58:03

Harberger:

Well, I would say the Chicago school is a big umbrella and under it will come Milton Friedman, T.W. Schultz, D. Gale Johnson, H. Gregg Lewis, Al Harberger, et cetera. Harry Johnson, Bob Mundell, to some degree at least, although they were more briefly there, so there's all of that. And I would say there is an Alito style. And it's not a school but it's what I try to teach my students. And it is to use simple tools artfully and to use observation forever. Be alert to what's going on and when you see something ask what is the machinery that makes this happen and if you ask that kind of question you will learn things. The things that we have talked about for China and for

Russia were there for everybody to see a long time before I was looking, so to speak. And somehow you didn't hear about them. And I take that to be sort of a blindness to the obvious evidence, not grasping what you've got right in front of you. And I feel the same thing with Argentina in the middle-to-late nineties and the real exchange rate disequilibrium that prevailed there that nobody wanted to recognize as such. And I think that is something that I try to instill to a degree in my students and something I tried to practice myself when I can. And most of the time I can say things that are surprising to people which really shouldn't be surprising. Did I tell the story about Ghana?

06-03:01:04

Burnett:

No, you haven't talked about Ghana really.

06-03:01:06

Harberger:

I was sent to Ghana in 2009 or 2010 and the issue was—see, I was tagged inside of AID as Mr. Real Exchange Rates. And the thing was that they had discovered oil under the sea off of Accra but it was still under the sea and they were just putting in the machinery to extract it and somehow in 2010 or '11 that was going to be spurting out. And obviously when it was spurting out there would be this huge influx of foreign exchange and that would cause a big appreciation of the real exchange rate and that would mean Dutch Disease. “So, Harberger, why don't you go there and write about that?” Okay. So what did I find? I found that none of that was going to happen. Why not? Well, in the time before I arrived there had been a presidential election in Ghana. The government in power had gone to British banks to borrow something in the order of eight or ten percent of GDP to spread the goodies around to give it a victory in this election.

06-03:02:40

Burnett:

In anticipation of the oil revenues?

06-03:02:44

Harberger:

No, forget the oil revenue. They wanted to win the election. [laughter] No oil revenue thought was involved, except perhaps the likelihood that future oil prospects helped guarantee the loan. But this money was pouring in that year and the interesting footnote to that is that government that paid out all that money lost by a half a percentage point or something like that and willingly left the scene and gave the government to the opposition, which obviously left me with huge respect for Ghanaian politics. But what was my report? My report was, “Kids, you already got your Dutch disease. It came with [laughter] this 8 percent of GDP pouring in last year so you don't need to worry about further currency appreciation coming when the oil comes in.”

06-03:03:48

Burnett:

I don't want to digress too much but I read your piece on Ethiopia, too. That's an interesting case. Do you want to talk about that a little bit? Two thousand ten? What was it? It was also a real exchange rate issue?

06-03:04:19

Harberger:

Well, the thing I remember most about Ethiopia was that it was experiencing an amazing rate of growth while having a very authoritarian, very interfering in some sense kind of government. And it didn't fit the free-market story that we were accustomed to and we were usually touting. I thought that this was one of those cases of a country whose economy in terms of GDP was a lot smaller than General Motors and since General Motors is run from the top, well, maybe such a country with a fairly simple agriculture and so on could also run from the top. A guy says that this crop is good, turns out to be good and you get some good things. This method of cultivation needs to be modernized and, bang, that gets modernized and gets good things. So that was in a sense my impression from Ethiopia, while at the same time being quite taken aback by the degree of command economy that prevailed there.

06-03:05:57

Burnett:

Going back to talking about the Harberger style, where you use simple tools artfully. It's really interesting when a social scientist will talk about doing something artfully. Can you say a little bit more about what art and artfulness mean to you?

06-03:06:25

Harberger:

[laughter, looking up] Give me strength.

06-03:06:30

Burnett:

[laughter] I realize it's perhaps not an entirely fair question. But yeah. You are very precise. All your research is data-driven and evidence-based. And here you are talking about artful oversimplifications.

06-03:06:59

Harberger:

Well, you look at things and you try to see some key feature of something that becomes the dominant story, you see. You had always this very complicated world out there. You have all these tools and so on. And you say, "What's the big story?" Well, in China we know what was the big story. The savings thing coming in on top. What the savings thing did was to cut short a whole evolution that would normally have happened of inflation, rising price levels and so on that didn't happen because of the way savings entered the scene. And then you've got to be aware of that. We get to Argentina and they have this big stagnation starting in the end of 1994. Well, 1994 was the Tequila Crisis in Mexico. And, indeed, when this Tequila Crisis occurred there was indeed a speculation against Argentina which the central bank handled with great adeptness with Cavallo in charge. Most of our people were blaming the ills of Argentina on flawed fiscal policy all through the late 1990s. And I was saying it's a real exchange rate problem. And how was I so sure it was a real exchange rate problem? Well, Tequila took place in roughly December of 1994. And I had data from October 1994 where unemployment in Buenos Aires was over 13 percent before we had any hint of Tequila. Well, that says to me this high unemployment that we were suffering had its origin before Tequila. Tequila came, it exacerbated, et cetera, et cetera, but it is not at the

core of this problem. This economy is trying to deflate and when it tries to deflate much of that pressure gets reflected in unemployment and that's what we're seeing. You're looking at one piece of evidence there. Well, you've got to know that that's a critical piece of evidence that is determining the interpretation. That's what I call artful economics.

06-03:10:22

Burnett:

Okay. So artful in several senses, right? Artful in the sense of—

06-03:10:27

Harberger:

Let's say in China, seeing that big expansion of money with no rise in prices, got to get behind that. That's the key. Russia: seeing the exchange rate, the same thing, ten years apart and a three-times price-level move in between. Wow. That's a challenge. What's behind that? You see?

06-03:11:00

Burnett:

You have a nose, right?

06-03:11:02

Harberger:

Yeah. You have to sense that you've got a problem here and be able then hopefully to create a story that explains that problem.

06-03:11:16

Burnett:

Right. So, yeah, that's what I meant by in a couple of senses. In an earlier conversation you said something like the trick of the economist is to get "a sense of things, the smell of things." When you were teaching you tried to give that to your students. And that to me is beyond the canon, beyond the sets of rules, that you know in a broad sense the regularities are true. So that's the canon you learn of price theory and the body of work of economics that every economist agrees on.

06-03:11:59

Harberger:

Well, let's say why most economics courses are pretty dull is that, and why economics can be interesting is this.

06-03:12:11

Burnett:

Right, right. The smell. And so you're talking about sussing out anomalies, interesting exceptions, contradictions. And for that you need to have a nose and that nose comes from experience.

06-03:12:30

Harberger:

And training.

06-03:12:32

Burnett:

And training. And training. But if it were just training it would be, "Here's the canon, apply it. Rubberstamp." And so it's in the discovery element, that is the artfulness. But the other aspect of artfulness is in the explanation, right. You're saying "what's the story." And there's the elegance of the explanation that is artfully simple and so there's a couple of ways in which you're talking about artfulness that I think are really interesting and significant. So we'll

allow future historians of science and economics to pore over that [laughter] and take it apart as they will. So backing off from that, you were talking about family and you were talking about Carl and Paul. So bring us up to date a bit more. So does the family expand at this point? What's going on?

06-03:13:42

Harberger:

Well, Carl has these two girls. Alyssa is in Emerson College in Boston and Anna is thriving here at Sierra Canyon High School. And they are both very wonderful children and exceedingly well brought up and living in their modern world but aware of the pitfalls, let's put it this way, that face people of their ages, and apparently quite cognizant of how to avoid them.

06-03:14:22

Burnett:

Well, not every grandparent gets to know their grandkids that well. So you get to spend time with them, you get to see them because they're here. Now the oldest has flown the nest, I suppose. So you're very tight with your family and tight with your colleagues and your students and that's also reflected in the family. Can you tell me a bit more about Anita? She was really the glue at the time of Chicago and when people were there and even at UCLA. You said that she made it kind of a family, as well.

06-03:15:10

Harberger:

Well, she was just a totally unique individual. She loved children. She had been in Chile a teacher of difficult children and she had her ways of getting the best out of even difficult children. She had a stroke, a modest stroke around 1999 and from there until 2011 when her life ended, there was a kind of a mental decline, gradual. But she traveled with me. She was with me in Ethiopia, she was with me in Ghana, she was with me in the eastern United States even months before she died. And she was traveling around. But over the years she could do anything. We bought this big house on Kenwood which was truly a mansion and it had a fireplace in the dining room maybe that wide, made of marble, and above the fireplace there was canvas mural around with oil paintings of hunting scenes. And up on the ceiling there were panels and they were also oil painted with gold and red designs. And at one point there started to be a leak from upstairs that marred some of that oil stuff in the panels. And, by God, she was up there with her oil paints painting, putting the gold leaf and putting this and putting that to the point where you couldn't tell the difference.

06-03:17:45

Burnett:

She restored it.

06-03:17:46

Harberger:

She restored it by herself with no help from anybody. How she got up that high over the table, I still don't know, and things like that. You know those shirts I have with the pockets? She made those shirts. She took the sleeves off and she made the pockets, never saying a word. We had a coach house there. And the coach house had a bathroom that was kind of crowded and messy and

so on. One time when we were between tenants in the coach house she went up there and she redid that entire bathroom, changing the walls of the bathroom, putting different floor down, and stuff like that. One time we gave her, what do they call it, a motorized miter box.

06-03:18:50

Burnett: Oh, like a jig or something?

06-03:18:51

Harberger: Like a saw that you can make angles with in the wood, yeah.

06-03:18:55

Burnett: Oh, yeah, yeah, yeah. Like a circular saw. Yeah.

06-03:18:57

Harberger: [laughter] We gave her that for Mother's Day.

06-03:19:01

Burnett: That's great.

06-03:19:02

Harberger: But she painted. I don't know. I think maybe we have—

06-03:19:11

Burnett: Do we have a painting here?

06-03:19:12

Harberger: There are several of her paintings floating around somewhere.

06-03:19:20

Burnett: Okay. Dr. Harberger, can you tell us what we're looking at right now?

06-03:19:25

Harberger: Well, that's a self-portrait of my wife that she did. Remember when I told you about going up to the Andes Mountain and the guides going out trying to shoot condors and Anita and me sitting watching the condors circling over our food.

06-03:19:46

Burnett: That's right.

06-03:19:47

Harberger: Okay. Well, shortly after we got back from that in the days that followed, we had our fireplace going in like a coach house that we lived in at that time. She put herself on the floor in front of that and painted this self-portrait of herself from a mirror. So before the family came she went to the Art Institute in Chicago. When we were in Santiago for six months she went to the Bellas Artes there to do this. When we were in India there was a sort of an organization called Triveni Kala Sangam, which meant three arts something or other. And she went there and did some paintings. I'll show you another of her paintings that's on Carl's wall here. And just that kind of thing.

06-03:21:01

Burnett: So a mixture of art and science in the family. Music.

06-03:21:03

Harberger: Art and just able to do anything, everything sort of.

06-03:21:15

Burnett: So the key, I guess, to a fulfilling and long life is something you're also an expert in. Can you tell us a little bit about what you find most deeply fulfilling?

06-03:21:41

Harberger: Oh, my. I think of it a different way. That I think my little secret, if any, is don't let anything bother you. I think forever of how lucky I am. That's my big thing in life. That I was born in this country, I was brought up by wonderful parents and have a wonderful wife and family. I had great teachers. I got to where I got and I think of all the people in the history of the world that had no such chance, no possibility. Friedman was a great believer in luck and I am a great believer in luck. I think that the pompous guys that get to be CEOs and something like that, they think they all did it themselves. I think that they are shortsighted and they do not realize how much they are benefitting from external elements over which they had no control but which gave them these opportunities. And to just be able to appreciate those opportunities and to think of how great it is to be able to lie down in a bed at night, in a warm bed, and to have air conditioning in the summertime and to be able to eat chicken seven days a week, meat every day in the week. That's a rarity among humans. And when people start nitpicking about this little thing and that little thing wrong, drives me nuts. Because they should appreciate where they stand and how lucky they are. That's my true credo.

06-03:24:18

Harberger: Stay humble, enjoy life, appreciate the little things.

06-03:24:27

Burnett: Dr. Harberger, I want to thank you for taking so much time to sit with us and talk about your career and your life.

[End of Interview]

Interview #7: November 25, 2016

07-00:00:11

Burnett:

This is Paul Burnett interviewing Arnold Harberger for the Economist Life Stories Project. And we are here in Los Angeles, California and it is Friday, November 25, 2016 and this is our thirteenth and final session for this oral history. So one of the things that's happened in the interim, between our last session and this one, is the election of Donald Trump to the presidency. And he's campaigned on a number of different issues and those issues have been rather vague in some senses. And commentators have variously claimed a lot of things about this but one of the things they've said is that this represents—whether it had been Trump or Bernie Sanders—this rise of populism in the United States signals some kind of rejection of what you have described as good economics, that there is, in some sense, a rejection of a kind of Washington Consensus approach. One aspect of that, I think, is a rejection of expertise itself, right? That we feel that the experts in Washington have perverted things, have gotten things wrong. At this stage, what are your thoughts on the rise of Trump? What does that mean in the history of what you've looked at in the United States and around the world? Are we at a kind of crossroads or—

07-00:02:10

Harberger:

Let me start, before getting around to Trump, at what I think underlies some of this malaise that you find not just in the United States but in many places. And people have noted, and I have noted for—I was saying in the nineties that real wages have not risen since 1970. The low-end real wages still haven't risen since 1970, or not very much. To what do I attribute this? I think the two major forces are globalization, which I define as the shift of comparative advantage in manufacturing from the United States and Europe to the Far East, which includes all of the countries, Taiwan and Indonesia, even before China these countries were rising. And, in some sense, Taiwan probably gave the example to China, to Deng Xiaoping, that this was a good track to take. I wouldn't be a bit surprised at that. So this manufacturing gets over there. I think I've said before—this jacket is suede, a faux-suede jacket I bought for a hundred dollars three years ago. If we were making this here in the United States you wouldn't get it for a hundred dollars. You buy shoes, you buy all these kind of things. The dollar store and the ninety-nine cent stores around here have wonderful bargains. Ross Dress for Less. I go to these places myself. And what do I see? I see poor people. So the poor people whose salaries perhaps are being kept down by the competition of the Far East are grossly benefitting from the cheap labor in the Far East on the consumption side. I just replaced my twenty-year-old TV for a forty-inch beautiful Samsung TV for \$399. Now, most poor families can not only have a TV, but they can have a forty-inch beautiful Samsung that gives them just about everything. I think people, to a degree, exaggerate the malaise itself but definitely underemphasize the benefits to the poor that come from this very same source.

When we do international trade and we talk about changes in the exchange rate and so on, well, a change in the real exchange rate, as we call it, will make exports cheaper. Your international tradable exports will become cheaper and that's going to hurt those who produce those things and it's going to make the imports cheaper and that's going to help those who consume such things. Well, if a country has balanced trade, to the first approximation, the benefits and costs cancel each other. One group is benefitting, the other group is hurting. But the amounts involved are supposedly about the same. When you have a deficit in the trade balance, as we do consistently, importing more than exporting, the value of the benefits to the users exceeds the value of the costs to the producers.

07-00:07:06

Burnett:

So there is the example of consumer electronics, for example, and so the poor are able to shop for these goods that have gotten cheaper and cheaper. In real terms, televisions used to be an extraordinary durable good.

07-00:07:21

Harberger:

It's a cost. Yeah.

07-00:07:21

Burnett:

Right? That you would save for it or pay on an installment plan and now there's no question. People can just afford to pay a TV outright even if they're living in a trailer park. I think some of the anxiety is around where the poor of the United States are falling behind, are the areas of access to education and healthcare, right?

07-00:07:47

Harberger:

That is for sure. And, in a sense, it's not just they that have fallen behind because those relative prices have been bouncing up, bouncing up, all along. I hate to sound like a Pollyanna here but there is no question in my mind, and I've heard experts on TV say the same thing, that as the price of healthcare is going up, so too is the quality of healthcare. Perhaps the weakest link in that type of argument is the issue of pharmaceuticals, where obviously the pharmaceuticals are getting better. They're getting better all over the world. But other countries get the same pharmaceuticals cheaper. Now, what do you do about that? And what it amounts to is that the pharmaceutical companies practice multi-part pricing and basically pricing to the market to which they are sending things. And if they price low in some markets they're covering probably marginal costs but they're not recovering anything in recompense for the seventeen years of research that went into this. And when their lobbyists bring this before the US Congress, the US Congress is generous in creating laws that permit them to be recouping these, in the view of Congress, having this avenue to recoup the investment cost and to continue stimulating the investment. Now, I am not one that has infinite faith in the Boy Scout nature of pharmaceutical companies. They're going to try to get money, sometimes for the purpose of recouping cost, but if the money is there to be had they're probably going to be getting it anyway. [laughter]

07-00:10:44

Burnett: [laughter] Yes.

07-00:10:47

Harberger:

But I think that should be said. Try to think of an alternate story. The alternate story is everybody gets the price in Slovenia or someplace, a very low price, and now there is no longer an incentive to invest. And that is painful for our future. We don't want that. But another option is we all get the same price but it's Slovenia price plus a margin which is now spread over all the countries of the world, poor and rich alike, and they get the same recompense for their investment but sell less drugs in the poor countries. May feel some humanitarian sort of regret on that ground but, again, I don't credit companies with large amounts of feelings of regret. When they do things that are positive in humane terms, I think they do it more for their image than they do for the pure altruism, so to speak.

07-00:12:12

Burnett:

Yes. And I think they are also pressured because, in the case of the HIV/AIDS crisis in Africa and following the lead of generic manufacturers in India —

07-00:12:24

Harberger:

Well, that's image.

07-00:12:25

Burnett:

Yeah, it is image and it's also foreign policy to some degree, if the United States government is involved in pressuring pharmaceutical companies to follow suit. And that's part of, perhaps, a non-economic question. Getting back to thinking about—I guess the question I started with is probably best posed as this aggregate person who voted for Trump, at what they have experienced in these red states, for example. There was an article, I think in the *Post*, about the 500 counties that went for Clinton produced 64 percent of the GDP and, I think, what is it, 2500 counties that went for Trump produced the other 36 percent. And so these are poor counties, rural or exurban. There's a whole set of analyses about the profile of the people who went for Trump. And thinking about what they expected, I think, about the sound economic policies that were pursued since the 1980s, let's say, globalization, when it was bipartisan, the Clinton Administration and the Reagan and Bush Administrations, were moving in those directions, as was the rest of the world. And they have lived through that period and they have not seen their wages rise, although consumer electronics and other things, clothing, are cheaper. What would you say to them about good economics that could kind of turn the tide or convince them of the benefits of globalization or, conversely, the danger in a kind of reversion to a more protected market?

07-00:14:38

Harberger:

Well, I have more to say than I probably should at this occasion. The first thing is that people get some idea in their head of something that is good and it becomes almost an ethic in its own right and they aren't thinking of benefits and costs. So I'm going to give you a précis type example. Our imports in the

United States have been 18 percent or so of GDP, let's say 20 percent of GDP to make a round number. And let's say that Trump puts on a 30 percent tariff, uniform tariff over all imports, which is what economists would prefer, if you're going to have tariffs. And as a consequence of that, imports get cut in half. That's a 10 percent cut of GDP. Well, that cut in half is presumably going to be substituted by domestic production. So what we're doing is shifting 10 percent of GDP from other sectors to these import substitutes. And that obviously will entail some jobs there and loss of some jobs where those things came from. I don't want to leave that. Well, what's the efficiency cost of that, the Harberger Triangle? The Harberger Triangle is the 30 percent. That's the vertical of the triangle. The base is 10 percent. Thirty percent times 10 percent is 3 percent. Triangle is one-half, 1.5 percent of GDP. That's the cost. Now, it's unfair to look at that in that way and say just 1.5 percent. You take that 1.5 percent and you have it growing at 3 percent per annum. And you take the present value of that over a long future, let's say at a 5 percent discount rate. That would be 1.5 divided by .05 minus .03. The present value of that would be 75 percent of a year's GDP [laughter] at that rate. So it ain't hay but, still, each given year it's only 1.5 percent of the GDP and we suffer from our sugar thing and from our—

07-00:18:11

Burnett:

Oh, the subsidies —

07-00:18:12

Harberger:

—ethanol business and so on, things that could very well be that size.

Certainly adding them up, we'll suffer more than that, from the inefficiencies that we voluntarily imposed upon ourselves. So what am I saying then? That if Trump were to put a 30 percent tariff, Harberger wouldn't be up in arms and say, "Oh, good economics has been just run roughshod and into the ditch," and all that. But now, suppose we get the other thing, that Company X says, "I need a 250 percent tariff." "Okay, here you go." "I need a prohibition." "Here it is." "I need a 75 percent tariff." "There you go." And so on. You start making tailored tariffs to specifically protect particular activities. And, boy, those triangle costs go way up and the inefficiency is unthinkable and cannot be defended in the way I sort of defended a 30 percent uniform tariff.

07-00:19:39

Burnett:

There's no comparison. That's the slippery slope that you fear.

07-00:19:43

Harberger:

Yeah. And that's where the political pressures will come. And it's even built into our law that people can appeal for protection against—it's supposed to be against dumping, but sometimes the dumping is more fictitious than real. And when they get this tariff it's just a tariff that's going to keep them in business in spite of what's going on in the alternative country. So we have to be very, very careful about that kind of cafeteria protection. Whereas I would say if they were to stick to uniform tariffs across the board, and there'd probably be a few exceptions—well, maybe a few exceptions—but stick to uniform tariffs

across the board. And you're not going to have them go to 100 percent or 50 percent. So they would be in a range where 30 percent isn't too bad an example. And, yes, they have a cost, 1.5 percent of GDP. Yes, that's an understatement of the true cost if you think of it in a long-run context in a growing economy. The present value could be very high. Why should we get ourselves into that kind of a mess if we can avoid it? But I certainly think that you want good economists in that soup-making operation [laughter] because if they're not there the prediction is pretty clearly disaster.

07-00:21:58

Burnett:

Yeah, yeah. And so far, the nature of the appointments to the cabinet and some of the staff positions would seem to indicate otherwise. So far.

07-00:22:07

Harberger:

Well, I don't know. Those appointments are not headed much on the trade side, as far as I could see, as of yet. And I think we're all keeping our fingers crossed that Romney will get it instead of Giuliani or somebody else.

07-00:22:26

Burnett:

I think we'll find out. The news may already have broken while we're talking. But we'll see. [laughter] We'll take a break and check.

07-00:22:35

Harberger:

Check on CNN, yeah. [laughter]

07-00:22:41

Burnett:

But yeah. There are so many aspects of it [election of Trump]. The threat to label China a currency manipulator when, in fact, since 2014, China has been trying to prop up its currency, right? [laughter] So there seem to be some absurdities in this.

07-00:22:57

Harberger:

I think China as a currency manipulator is much less of one than—I went back and looked at the balance sheets of central banks in a bunch of countries. This was sometime post-2004 when, again, China was already being—

07-00:23:30

Burnett:

Labeled, yeah.

07-00:23:33

Harberger:

—labeled as a currency manipulator. Yet, indeed, for a while, in the beginning, from 1996 to around 2004, the central bank not only was acquiring foreign currency, it was acquiring domestic assets, as well. Now, the tests of intervention, sterilized intervention, what they do is they sell domestic assets. They sell government bonds, their own bonds, commercial paper that they've acquired, and with the proceeds buy foreign exchange. You can see that in some sense, a probable over-estimate of the degree of cumulative intervention is the amount of foreign exchange they hold. Well, they should hold some foreign exchange anyway. So that's an over-estimate. But when I made this exercise, looking at the different central banks around the world, Chile was

worse than China, Argentina was worse, Columbia was worse, India was worse. Singapore was way, way worse. Seventy-five percent of their assets [laughter] were in foreign exchange. And I'm saying if you rationally are going to start pointing fingers for currency manipulation there are plenty of places you ought to be pointing before you reach China.

07-00:26:13

Burnett:

Yeah. Although I think it's perhaps the scale of the economy and the scale of integration with the US market that causes the concern.

07-00:26:18

Harberger:

Yeah. Well, but no. They just are arguing against the low wages in China; They're not arguing against currency manipulation. The actual real exchange rate of China has drifted in a strengthening direction for the Yuan or the renminbi with a couple of little blips in the opposite direction. But it's certainly not a big story of them trying to further devalue their currency. And the IMF has properly stated there's no case to be made for currency manipulation by China.

07-00:27:10

Burnett:

But these are kind of public fears, right? Back in the eighties there was this fear of dumping from Japan, right? That the Japanese are unfavorably—

07-00:27:21

Harberger:

Well, let's go slow, you see. Let's go slow.

07-00:27:24

Burnett:

In the public mind—

07-00:27:26

Harberger:

There is a fear, in a sense, there is a nostalgia for the time post-war when America accounted for 50 percent of the world's GDP. That's the first point. That was the time, by the way, of the Marshall Plan, when we were very open and generous, given the Soviet threat, I might say. But it was definitely generosity and it was genuinely self-interested generosity.

07-00:28:03

Burnett:

Of course, yeah.

07-00:28:07

Harberger:

So you're moving from that time. And now the rest of the world's economies start to sprout and grow. What people see is this increased competition from abroad. They want to go back to that fifties time. I've argued in my monopoly paper that enterprise monopoly isn't as great as people imagine. And people aren't able to charge double the cost of something in any semi-monopolistically competitive arena. My work on monopoly said this: If capital is getting 25 percent of GDP, what piece of that isn't really a return to capital but is this monopoly tax that the monopolist puts by raising prices? Well, in that paper what I did was to say everything that was above average return we called monopoly [laughter] and found only very modest allocation

effects coming from that monopoly. Okay. I wouldn't say that about the United Steelworkers or about the UAW. See, what the UAW does is it raises labor costs for Chrysler, Ford, General Motors, Jeep, whoever is in the market.

07-00:30:04

Burnett:

Across the industry.

07-00:30:06

Harberger:

They're all facing that. So their competition among themselves doesn't do anything to abate that. Okay. Same thing with the steelworkers. You had the steelworkers union. Now what comes is Toyota, Volkswagen, Renault, and everybody else coming in with international competition. So the UAW doesn't have any clout over them and the power of the UAW erodes with this product competition in automobiles. By the same token, the power of the US steelworker erodes as foreign steel gets into the picture. So these guys, dreaming back to those good old days, are not having a realistic sense of what the reality is. They somehow think it's something in trade or something here or something there. They don't like to see jobs shifted overseas, which obviously do reduce costs and do benefit our consumers. But I have always said when I give a litany like this that when people talk about the great virtues of this globalization and stuff like that, the benefits do outweigh the costs in our usual way of measuring them. But we know that the benefits are going to people who are buying these import things and the toughest costs are going to those who used to produce the domestic competition. And I think that is there, especially in small semi-rural towns which have a few factories and all of a sudden the factory decides to transplant to China or Taiwan or someplace and then those people get angry. I see nothing wrong with those people being angry. I don't particularly see a way of restoring their old pattern of life, you see. That, I think, is a chimera. I think it's a shame if they can only get jobs at McDonald's instead of in the steel mill with wages of one-third probably of what they used to get.

07-00:33:27

Burnett:

Lower, I'm sure. Yeah.

07-00:33:30

Harberger:

But people go into retraining workers. You get workers that are forty-five, fifty years old. What are you going to retrain to? They're going to drift out of the labor force, which they did. When most of these comparisons are made, those comparisons are of earnings and they do not contain the benefits of the food stamps and unemployment compensation and disability payments. Even Social Security probably should be in there, although they contributed to the Social Security so it shouldn't be considered that they are receiving charity by that.

07-00:34:28

Burnett:

Right, right. I guess one of the concerns, too, is that if, behind all of this policy bluster from the incoming Trump administration, there is behind it also an effort to do away with a lot of those social supports. So, as you point out, I think there are a lot of contradictions in the impulses of some of those voters in some of those areas, that they have experienced declining real wages. To take an example from TW Schultz, one of the things he was advocating— because there was an exodus out of the countryside—

07-00:35:11

Harberger:

Out of agriculture, yeah.

07-00:35:13

Burnett:

—out of agriculture. A lot of the New Deal farm policies were about giving the just price, the price that the farmers deserved.

07-00:35:24

Harberger:

Preserving the family farm.

07-00:35:26

Burnett:

Preserving the family farm or preserving a ratio between industrial and agricultural products back to 1914. There are all these kind of translations of farmer discontent into concrete policy. And Schultz was one of the folks who argued, probably one of the very few at the time in the 1930s and forties, arguing that this is retrogressive and that, yes, the state, the government should help agriculture but it should help it to modernize, to reduce the cost of the final farm product. And then those who can't participate in that transformation and are just earning lower and lower wages or stagnant wages as sharecroppers or whatever—

07-00:36:09

Harberger:

Help them move out.

07-00:36:10

Burnett:

—should get out. Yeah. That the migration is happening anyway and it's a good migration and they can get better wages in the city. So those folks did move into manufacturing jobs in the cities. And so now 2 percent of the population works in agriculture and there are people who are kind of, by some measure, stranded in those places. They find it difficult. When people tell them, "You're living in rural Indiana and you're not making a good living. You should pull up stakes and move to the coast where you could get a better job." And they look at their education, they look at the barriers to entry to living in a place like the Bay Area of San Francisco and they say, "I can't afford first, last month's rent and a security deposit. That's more than I make in four or five months of work." So there's this sense that they're kind of shut out. But in another sense mobility, labor mobility, is a kind of an American story. That people have—

07-00:37:20

Harberger:

It is an American story. Where there are big cataclysmic forces at work, they work slowly. Appalachia was way down on the list of counties back in the 1930s when migration out of Appalachia was started, let's say. And thirty years later it was still down and the out-migration was still happening. And today I'm pretty sure it's still down. I bet the migration out is still happening. Yes, these migration forces work but they work at comparatively a snail's pace.

07-00:38:06

Burnett:

I think one other piece of this story, too, is in terms of the popular discontent. You were talking in an earlier session about the working out of good economics in Chile and the ways in which there's scarcely a difference among the major political parties in their basic policy platform as regards economic policy. That's kind of evidence of good economics working itself out. People figured out that this stuff works and it's beneficial. Seen another way, from the folks who feel like they don't trust this stuff, is they see all the major political parties, for example in the United States, hewing to—

07-00:39:00

Harberger:

A line.

07-00:39:01

Burnett:

—a line of good economics. And for them, that's evidence of undemocratic forces at work, that there's rule by experts, there's a technocracy at work that's decided what's good for the country without democratic input and there's no choice that the people have. There's no input that they have as voters in changing the direction or the economic direction of the country. So there's myth-making going on, there's discontent, and the perception of an exclusion. There's a perception that there's limited choice and they feel frustrated by that. Is that an unintended consequence?

07-00:39:45

Harberger:

Well, I don't know. When I believe in good economics I also believe in technocracy for good economics. That economists have answers and so on. But I've said many times that others deserve seats at the table and economics tells me itself that if you have goal A and it's going to take you to here. And if you have goal B over here that isn't identical with goal A and you want to improve goal B, you have to be willing to sacrifice something from goal A in order to get goal B. I think that kind of thinking should be present. These guys who say, "Do my policy and you'll get 7 percent growth." I hear it all the time and it's pure garbage all the time. [laughter] You might get .07 percent growth, which you could hardly measure, from one policy. You would need many, many, many policies to take you up from three to four percent growth, let alone go to seven. People exaggerate that way. I think that what we have to worry more about, and what we don't worry enough about, why the hell have we had this stupid sugar policy since I was a graduate student?

- 07-00:41:31
Burnett: The protection of the—
- 07-00:41:33
Harberger: We have the highest priced sugar in the world, which we satisfy our disruption of trade by allocating quotas to poorer countries so that they can sell and we give them our high prices as a kind of a sop to salve our conscience. We're giving this kind of charity to Haiti and Dominican Republic and—
- 07-00:42:08
Burnett: So they can sell at that similar higher price.
- 07-00:42:10
Harberger: And so they get to sell some sugar at the American price. Right. But this has considerable cost to the American consumer. And who in America does it benefit? These are big, rich sugar planters mostly in the south.
- 07-00:42:32
Burnett: Well, also corn. Is this a subsidy specific for a specific variety of sugar production or is it for, say, the production of sugar no matter how you produce it? So corn—
- 07-00:42:47
Harberger: No, I think it's straight sugar. What do they call it? The fructose from corn is a competitor to sugar. Yeah.
- 07-00:42:59
Burnett: Okay, okay. Under this system.
- 07-00:43:00
Harberger: Yeah.
- 07-00:43:02
Burnett: Yeah, yeah. Well, going back to the example of T.W. Schultz. There are policies that he advocated that were not good economics, right, in some sense. He had this program of forward prices for agricultural subsidies, so that the agricultural subsidies would be pegged to a quasi-market price set some time in the future. So the government would announce a price—
- 07-00:43:24
Harberger: Yeah. Well, wasn't that D. Gale [Johnson] more so than Schultz?
- 07-00:43:27
Burnett: Schultz started it. He really started it and then D. Gale [Johnson] took it. He wrote the book.
- 07-00:43:31
Harberger: Wrote his book about it.

07-00:43:33

Burnett:

On forward prices. And it kind of got into government policy at a certain level. But it was this effort of compromise. So there's the ideal of, let's say, free trade and agriculture. I think even a lot of the New Deal farm economists subscribed to an ideal of free trade in agriculture but they realize that there's a farm lobby, there's a Farm Bureau, and all of the industries that are related to farming, that exerted a powerful influence, and they hewed to a notion of the just price. So what kind of compromise can you effect? And that's what you're talking about when you're talking about these compromises between policy A and policy B.

07-00:44:16

Harberger:

Yeah. And what I'm saying is that God help us if we have technical innocents doing that. That this kind of compromising, which I don't find anything wrong with—I say if you've got goals A, B, C, and D, you've got to be sacrificing each at some degree for the benefit of the others. Our mechanics of devising minimum cost/maximum utility all entail exactly that! It's always if you have something where the marginal utility is high and something where it's low, you want to expand this one, you want to contract that one, so you bring the marginal utility down here, you bring it up there, and that's how optima are reached. So that's the only thing I would hope for in this revisiting, so to speak, of the policy scene. And what I really worry about is these enclaves, of which the sugar program and the ethanol program are perfect examples. That those things ought to get blasted out to bring some greater rationality into our policy. I'd say even more sugar than ethanol because of the fewness of the sugar producers. Ethanol, there are quite a lot of corn farmers but not so many sugar producers.

07-00:46:02

Burnett:

If we still have significant agricultural programs, they're ones that are protecting producers in these areas that went for a more protectionist Trump, a Trump policy position. So they're likely to be catered to. I'm imagining. I don't know. We'll see what happens. But that is a concern. I think there's a lot of worry, not just on the economic level but on the social level, about what's happening in the world right now as a consequence of this.

07-00:46:43

Harberger:

Well, I hope that Mr. Trump gets a team that will insert better economics into his thing. He should give up the idea that we were being screwed by anybody we have a deficit in the trade balance with—we're getting the imports, we're paying for them. [laughter] What's the story? And the other side of the deficits is something that, again, you don't get. When we have a deficit in trade, obviously we're living beyond our means. Okay. Well, now there are two ways a country can live beyond its means. It can be having some international reserves and it's just losing these international reserves like nobody's business. And in general, certainly after a certain point, that becomes even dangerous because the reserves are being carried down to where they are no longer able to perform their normal function. But we don't have that. Our

deficits are financed by other countries putting money into the US and they are being optimistic about the United States. They are stating their faith in our economy, their trust. And the fact that they are willing to do this is a benefit to the United States. And we have the other thing. The other element of deficit is the hundred-dollar bills that go floating around all over the world in mattresses and safes and everywhere else, we are printing these hundred dollar bills for twenty cents each and we sell them to the rest of the world for a hundred bucks. The best deal ever. [laughter] We get paid in goods and services for these dollars that we send abroad. It costs so little. And we get real goods and services for that. That's known as seigniorage.

07-00:49:27

Burnett:

And for a while there there's concern about is this going to be the reserve currency for the world. Is this going to continue? For a while there was the talk of the euro and then possibly the renminbi.

07-00:49:43

Harberger:

No, the euro's for the birds.

07-00:49:44

Burnett:

Right, right. At this point.

07-00:49:45

Harberger:

And the renminbi has a long way to go. [laughter]

07-00:49:50

Burnett:

So there is this interest in maintaining the good faith value of this currency, right, through sound economic policies and sound financial policies and that is part of the factors that we're looking at. Another thing that you've been deeply involved in, another project is benefit-cost analysis and you're co-founder of the Society for Benefit-Cost Analysis. One of the areas that cost-benefit analysis has been really working in is trying to price these areas that are not typically priced in the market. They're kind of outside of the market. And so I was looking through the *Journal of Benefit-Cost Analysis* and there are articles about cap-and-trade policy in Canada for carbon and things like that. How do you price these non-economic things or things that could become economic later? What's the price of the atmosphere? And there's a lot of research being done in this. Can you talk a little about the growth in this kind of research and some of the benefits that this can have for a kind of supplement to the study of market economies?

07-00:51:30

Harberger:

Well, speaking personally here, I got into the benefit-cost business—I guess my first papers were on the relevant discount rate way back in the late fifties and the early sixties. That issue keeps alive. Even to this day I worked a lot on that in India when I was there. And I have always been an advocate of benefit-cost analysis, of public projects and programs, because that's what you're supposed to do. You're supposed to analyze in a way, as a business analyzes a project, will it turn a profit or will it not turn a profit. And it insists on a

competitive rate of return, something that at least a little more than covers the cost of capital to that firm. What's the cost of capital to a government, to a society, the cost to society of the government borrowing money? And we tried to quantify that. Then you want to test the benefits and the costs. And there are some things where we do an excellent job. We are incredibly good at evaluating highway improvement programs. If you want to worry about infrastructure in the United States, where does it need help, well, what ought to be done is each project ought to be evaluated. And there are going to be some that yield 20 percent, 30 percent returns. They should get the priority. And there are others that'll yield negative returns and they should never be done. What we don't want is each state getting a certain fraction and each road getting the same amount. Say, 20 percent of its last year's budget is going to be increased with a federal grant. And so you're gilding the lily in some places and you're not doing anywhere near enough in other places if you put a global extra investment into highway improvement. But if you pick and choose and do your studies, do the ones that need it, don't do the ones that don't need it, you're going to get real value for money. And we know how to do that. We know how to do that for ports. We knew how to do that for highways, we knew it for irrigation projects and things like that.

But there are many other areas where we are missing something and environmental, as you mentioned, is one. Nobody, nobody, nobody knows how much the world economy suffers if an extra ton of carbon dioxide goes into the air. Nobody knows. And when people make estimates they range from, say, ten dollars a ton to a hundred dollars or more. And this is a range that's so big, it's like my favorite prediction when I see a pregnant wife of a friend. I say, "I can predict the height of that baby when the baby reaches twenty-one." They say, "What do you mean?" I say, "Yeah, more than three feet and less than seven." [laughter] And I'm 100 percent right, but I'm conveying no information. [laughter] And that is exactly what you get if you say carbon is worth between ten dollars and \$110. But we can do well if we have a number. In Britain, I think, or in Europe, they originally put the number around twenty dollars a ton. Well, if somebody gives you a number like that you can avoid a project that pays thirty dollars a ton to save carbon from the air and really push projects that do it for ten dollars. And so you're being economic within this context, even though the number that you have isn't itself some deep truth, it gives you efficiency up to that point. Now, we call those things shadow prices and we economists don't have the key to estimate those numbers in the case of carbon emissions. And that's why we need somebody to tell us. And it could be the cost-benefit authority of the country, whoever is in charge over there. Could be Congress, could be the Department of the Interior, could be the cabinet of the United States, could be whatever. And once we get that type of number for a whole range of projects, instead of being able to work with only a third of the programs, the irrigations and the roads and the ports, we have another third of the programs that we can work with and that we can help.

And then we've got yet another third, which are like defense. I think, if I were asked to study whether the Air Force needed a new base or needed a new squadrons of planes, or if, even more, we need a squadron of planes for the Air Force or a destroyer for the Navy or a new division for the Army, which of these should we take? My economics doesn't tell me anything. I have no expertise. If I accept to do that project, I am demeaning my own professionalism, that I cannot be proud because I know I don't know. And my line has always been when I don't know I tell people I don't know. I am willing to sit down and discuss and goodness knows what. But the fact that I have any deep professionalism that is going to help this decision between Air Force, Navy and Army, no way.

07-00:59:21

Burnett:

It's a strategic consideration. It's not an economic one. And that depends a lot on the professional defense assessment of the risks and—

07-00:59:31

Harberger:

Yes, exactly. What are the benefits and what are the costs? And you need them in dollars.

07-00:59:38

Burnett:

Yeah, yeah. I suppose economic rationality must and does come into defense budgeting at all times.

07-00:59:47

Harberger:

Well, minimizing cost is easy, you see what I mean?

07-00:59:51

Burnett:

Yeah, yeah. And I think in the beginning of the Kennedy Administration there was a shift to long or longer production runs of weapons, which had—

07-00:59:59

Harberger:

Sure. Cost-reducing aspects.

07-01:00:03

Burnett:

It had cost reducing aspects but also a kind of problem in that you're producing way more weapons than you actually need for your strategic considerations so that leads to an arms market, right? Anyway, that's perhaps a bit of a conversational red herring. But there are these other considerations that you have to be careful of as an economist and you have to rely on other types of expertise. That's your department. You tell me what the price of a healthy child is, for example, that's not in the market. I'm thinking of some of the basic-needs literature for development in the seventies, where they're saying—like Ester Boserup's evaluation of development projects benefitting men but not necessarily women as much. And so do we put a kind of shadow price on policies that help or can help women and what would that be? And you're concerned about that? You're—

07-01:01:09

Harberger:

Well, I think that's too broad a brush, help women. Too many women are in perfectly good shape but there are women that really need help. And if we're going to be working in that area we should identify what the society believes are truly needy people of any gender, or age and how much extra society is willing to spend to give them a benefit above and beyond what they would spend in any other direction. Where we're ready to pay \$120 to get a hundred dollars' worth of food into a starving family. Okay, that's the kind of story we have to be thinking of. And putting shadow prices in that way. We are not willing to pay \$200 to get a hundred dollars' worth of food to that needy family, even though they really need it. We have to use our economics and some intelligent sense and say we're willing to do it for 120, maybe 130. And if they're super needy, maybe 140. But not 200.

07-01:02:54

Burnett:

Right, right. Or look at policies that might be in much more of the teach-them-how-to-fish variety, where there's an initial investment that can yield more economic activity.

07-01:03:05

Harberger:

Well, those are in the picture. They're right there already. It might be exactly how you would be spending \$120. [laughter]

07-01:03:18

Burnett:

Right, right. That could be generative. It could lead to other kinds of productivity that would benefit that group specifically. And so as development literature accumulates in the seventies and eighties they're concerned about differential impacts on different groups and I mention women as one of them. So there's this basic-needs analysis that comes into the picture. You spoke off-camera about Glenn Jenkins' work on stakeholder analysis. Can you talk a little bit about that? Is that a fundamentally different way of approaching things?

07-01:03:57

Harberger:

No. It's actually of a piece. If you think of a supply and demand situation, okay, and you put a tax and what does that tax do? Well, the price was ten dollars if you had pure supply and demand and no tax. But when you get the tax the price goes up to eleven dollars for consumers and down to nine for producers and the quantity goes down a certain amount. Okay. Well, in many cases we're worried about the quantity. And we're not worried about who is suffering the cost or the gain. Now, when we have that tax picture we have the demanders are paying eleven instead of ten. So that's a cost to demanders. And they also bear a little piece of that triangle, the stuff that they no longer want to buy because they're not willing to pay for that. Then for the suppliers they're only getting nine instead of ten, so they lose that extra one and they also lose the part along the supply curve where they're no longer willing to supply. So you have those areas right there in the supply and demand that tell you who are the winners and who are the losers from this thing. Identifying,

when we do the benefits and costs, how these benefits and costs accrue to this group, to that group, to the other group is, A, very interesting, often quite challenging from the standpoint of the economics itself. But it can be extremely useful in the political sense, that you get groups that are able to almost veto a project and maybe there is some way in which that project can be modified or even an extra sop invented, something entirely different, “Look, we’re going to give you this if you shut-up about that.” [laughter]

07-01:06:39

Burnett: Right, right. Some horse-trading.

07-01:06:43

Harberger: And get a good project approved. It’s a little bit like—you know what Pareto Optimal means? Pareto Optimal is an economic concept that says, well, we have a project or a program or something and we want to see that every single entity in society gains.

07-01:07:03

Burnett: Without anyone else losing. Right.

07-01:07:06

Harberger: Without anybody losing. Yeah. Well, in real-world terms, that is so pie-in-the-sky that it’s not even worth thinking about. But the sort of work that Glenn does in trying to identify the stakeholders and where those gains and losses accrue I think is extremely useful and certainly maybe it would be useful in any kind of a governmental situation, but even more so in a democracy.

07-01:07:41

Burnett: Right, right. And I think that speaks in some sense to this question of the role of economics. In a political context, where there is so much mistrust, I think it seems like there needs to be more frank public conversation about how policies can benefit people. The trouble in politics is that people paint the rosiest picture possible. Some politicians are more responsible than others in that respect. But getting public education about what’s possible economically and that, in fact, stakeholders can be brought into the design of projects. And I guess they’re learning that themselves by lobbying and advocating.

07-01:08:38

Harberger: Well, I think we have to worry also about the tremendous growth that we have had in sort of identity politics. It’s stuff that the media grab onto and they never, never, never try to break it down. The gap between pay of men and women. Claudia Golden, who was a student of Bob Fogel at Chicago, has written about this. Finis Welch is another who has written about this. When economists study the gap in pay between men and women, most of it lies between occupations. It isn’t that the male nurse gets paid that much more than the female nurse or the male bus driver gets paid that much more than the female bus driver or anything like that. It’s that the occupational distribution of men and women varies. Then you say, well, there could be a lot of discrimination in that. I believe that there is some. The glass ceiling, you see,

means that the top executives are mainly male, so how can you compare? Well, now we have top executives who are women and the glass ceiling is not as big as it was before. But I'm certainly willing to concede that some such ceiling is still there. But the idea that the same employer is paying very different wages to men and women doing the same job is not a very realistic story about the United States today. A fair amount of the gap between men and women's pay comes from the fact that women choose occupations, that they would much rather be nurses than interstate truck drivers. And there's a big gap between the pay of the nurse and the interstate truck driver and there you've got a part of the story. Now, that's the only element that I would want to add to that. But it is annoying to me that only by talking to economists practically does one become aware that this gap of 23 percent might be as small as five percent if you're doing comparable to comparable.

07-01:11:59

Burnett:

Right. Larry Summers has written about different factors. He's gotten into the most hot water for something. He talked about aptitude and he, I think, lost his position at Harvard because of it.

07-01:12:17

Harberger:

Oh, yeah. Yeah. Well, at Harvard, yeah.

07-01:12:19

Burnett:

Yeah, yeah. He got into hot water for that. Among his three justifications for the gap, he talked about the high-powered job hypothesis. So if women are disproportionately responsible for childrearing and childcare—

07-01:12:39

Harberger:

Of course.

07-01:12:38

Burnett:

—and they are, and that's a social and political issue for us as a society— then there are certain jobs that require near total commitment to be able to perform well that are out of bounds for women who have chosen to rear children and bear more of that responsibility than their partners.

07-01:13:01

Harberger:

Yeah, but there are other women who do.

07-01:13:03

Burnett:

Yeah. And there are women who do and they're often childless or they have economic supports to be able to do that. There are definitely these social factors.

07-01:13:18

Harberger:

Yeah. I think there is such a thing as rational discussion of these issues and there is such a thing as demagogic displaying of gaps that are, in any conceivable respect, exaggerated. That is, I think, what we have to worry about. It's an unfortunate truth.

07-01:13:54

Burnett:

Yeah. There's economics, which occurs in a complicated social, emotional, political, historical climate. And so if you're talking about starting the clock from a particular moment, person A, person B, person C having particular advantages or privileges, that is something that is—I think in economics we have to have a better way of kind of factoring that in.

07-01:14:24

Harberger:

There is no question that, in my lifetime, the emphasis on the individual has really gone down and the emphasis on the group has really gone up. I can see lots of usefulness in that type of emphasis on the group. But on the whole I would much prefer if cases where emphasis on the group was indeed important, that it shouldn't rob time and attention from the emphasis on individuals in their own right. Look at our prisons? I think, why do we have so many prisoners in the United States? I cannot believe that it is in our deep national interest to have as many prisoners as we have. We got there from laws that put minimum sentences and things like that. We got them from an attitude toward drugs that may be less than scientific, let's put it that way. And here we are. A lot of these prisoners come from social situations in which society is taking teenagers and making criminals out of them. And we have to worry about that. And when we let people out of jail we have to try to let them out with a feeling like somebody feels when they come out of the Marines. Very capable and proud and ready to play a role and all of that. How can we bring something like that about in this society?

07-01:17:05

Burnett:

And society ready to receive them. That's the most important point, right, because once you have a criminal record it's a death sentence in some ways, right? In the *Journal for the Society of Benefit-Cost Analysis* there was a great article on the choices that people make in different socioeconomic circumstances. And so it's looking at the ways in which someone from a disadvantaged situation may make non-economic choices, might make irrational choices, and figuring out how to factor that into cost-benefit analysis when you're looking at policies targeted at a disadvantaged group. Right? How can you get people to make choices that are going to benefit them in the long run if people don't believe in the long run? That's a larger social problem that we have and it's related to some of the things that you're talking about, I think. Well, we will not solve all of those problems in the remaining time.

07-01:18:22

Harberger:

No. Not today. [laughter]

07-01:18:26

Burnett:

There's a couple of things that are worth exploring in more detail. One is the genesis and flourishing and denouement of Advanced Training in Economics. Can you talk about how that really gets going?

07-01:18:44

Harberger:

Okay. That was a very interesting story. This was at the end of the Reagan Administration. George Shultz was Secretary of State and Allen Wallis was, I believe, Deputy Secretary of State. My friend and former student, Martin Bailey was Allen Wallis's right-hand man. So there they were, the three of them, and they— the Reagan Administration — had inherited a foreign aid program from its predecessor and entailed in this were commitments for the next five years, for the next three years, for this and that and the other thing. And they got to thinking that they wanted to leave an inheritance, too, and they wanted to leave an inheritance that they felt confident was really good and valuable for society. And they said to themselves, "What is the best money AID ever spent?" Well, they had no doubt the Chicago program with the Catholic University [Chile] is the one, you see. Now, indeed, I think I may have told you, but the Catholic University for the last ten years has been rated the best economics faculty in Latin America.

07-01:20:17

Burnett:

By whom?

07-01:20:17

Harberger:

Well, by an entity that does this rating. When we began, it didn't have one full-time professor, so you can see that that was really a wonderful aid thing just in the academic side, not to mention the spillovers into policy as these people got jobs as ministers, et cetera, bank presidents and all of that. So anyway, they were all so enthusiastic about this. Bailey had actually worked down there with me in Chile for a while, he and his wife. So anyway, they wrote letters to Clay LaForce, the dean of our business school, and me saying, "Come up with a proposal." And so we put our heads together and we made a proposal that would do things for people like the ones we had trained. And it would be countrywide. It would be from Latin America. But it would be people from top institutions who would come to UCLA, to Harvard, to Chicago, et cetera, and they would be well-selected and be trained in the kind of thing that I called good economics, meaning not super-technical stratospheric stuff but—

07-01:22:04

Burnett:

Theory.

07-01:22:05

Harberger:

—real-world functional-type economics. So that's what we wanted. And we sent in some kind of a document to them and I was called into Washington talk with the AID people and I think Bailey came with me to AID and I outlined our program and they said, "Well, who do you expect to come here?" "Well," I said, "we want like Brazilians from the Pontificia [Catholic University] in Rio and from Sao Paulo and from [Fundação Getulio] Vargas and from Argentina we want from [Universidad del] CEMA and from Tucumán and from Rosario and from Mendoza [Argentinian national universities]. Chile we want from Catolica [Catholic University of Chile]and

Universidad de Chile.” And they said, “All those countries have graduated from AID. We’re not giving aid to them anymore.” And I said, “Well, who do you want?” “Well, we want students from Haiti, students from Guatemala, students from El Salvador, students from Ecuador.” And I said, “Those guys can’t get into these universities.” And this was the stumbling block. So they said, “Well, what can we do about that?” So anyway, what emerged from this was ATIE [Advanced Training in Economics]. And in that particular case I, and I alone, chose ITAM in Mexico, CEMA and Tucumán in Argentina and Catolica in Chile, four universities where former students of mine were active, not exclusively by any means, but were there. Universities that had a tremendous track record and where I felt that they were not overburdened with super-tech. They had it, as any place in those days had it, but not in such a way that students didn’t get a lot of good basic economic instincts by the time they came out.

So these four institutions were then contracted to receive people from AID countries and they did so for a period pushing ten or eleven years. They trained a lot of people, many of whom went back to their countries. One of them went back to El Salvador, I believe, and became president of the central bank very quickly. Another, Laura Alfaro from Costa Rica, studied in Catolica and then she came to UCLA for her dissertation and then she was appointed assistant professor in Harvard. She is now a full professor in Harvard but she had to take a leave from Harvard in order to be minister of development in Costa Rica for a while. She is the star, so to speak, of the ATIE program. But Edgar Robles didn’t go to ATIE in Chile or Argentina. He came directly to UCLA and he became vice minister of finance quite early and has for a long time been head of their securities and exchange commission in Costa Rica. So anyway, I haven’t tried to dredge up the whole careers of all of these people but all that we hear is good and the program was not drastically expensive or anything like that. It turned out to be a way of coping with the big issue, which was if you take these people directly, they are not well enough trained. They’re going to be swamped if they come to a top American university graduate program. And having a two-year master’s type program in these four institutions created a path whereby these people were good, A, to go back to their own country right away and to be professionals right away and, alternatively, to come to American institutions and finish a PhD.

07-01:27:25

Burnett:

Right. And it lasted for how long?

07-01:27:30

Harberger:

For about ten years. What happened was we talked earlier about the ICEG program.

07-01:27:37

Burnett:

Right, we did. Yeah.

07-01:27:38

Harberger:

And how that had such a wonderful library, such a wonderful reach to think tanks all over the world and had no enemies. No enemies. ATIE had no enemies. But in the scramble for new funds in the new administrations, no big forceful supporters. I could be a forceful supporter but my clout is not up to that, you see.

07-01:28:11

Burnett:

It sounds like a wonderful program to scale up. It sounds also like it's in line with this tradition: that human capital is the key in many respects and how can you get from A to B? How can you get top-notch training?

07-01:28:33

Harberger:

Exactly, exactly. I am just so confident that what's the big change among less developed countries between when I first came onto the scene, so to speak, and now. When I came onto the scene there were people in the ministry in Chile who were saying economic idiocies, you know. And now, they've got PhDs from all over the place and they are doing intelligent things and they know how to analyze new proposals and so on. It's a totally different picture. And they have people coming back from the [International Monetary] Fund and the [World] bank where they've gained experience. Our people go to the fund, get trained, go back to their countries from there and take on major responsibilities. It's just a wonderfully different world and I think a lot of the benefit that we have seen in terms of people emerging from poverty and so on, the real standards of living, particularly of the poorest people of the world, going up, infant mortality in those areas going down, that these types of programs and the functioning of the Fund and the Bank are key in bringing all that about.

07-01:30:21

Burnett:

Well, your role in this, you have been celebrated, you've been given a number of awards in different domains, and you have been awarded most recently, since we had our last interview. Can you talk a little bit about that?

07-01:30:41

Harberger:

Oh, this is a Mexican foundation that invented a Life for Freedom award. I believe they said their first award went to Gorbachev and another one went to Václav Klaus from Czechoslovakia. Another one went to Liam Ferguson from Harvard. Álvaro Vargas-Llosa from Peru had another one. So I don't feel that I deserve to be in that kind of company but they gave me the award this year. And I was very happy to accept it and had a good time meeting former Mexican students in the process. I had former Mexican students from Chicago and I had former Mexican students from UCLA and both groups were very warm and appreciative and so on. The satisfaction that I get from the teaching business, so to speak, is when people think of themselves as my students. It's not me saying, "I had this guy in my class."

07-01:32:26

Harberger:

It's the way I feel vis-à-vis T.W. [Schultz], Milton Friedman, and [Jacob] Marschak, that they really impacted my thinking and I can sort of trace their influence in all kinds of little things that I do sixty years later. [laughter] So these Mexican students that were with us in this ceremony and the dinners that they had for me and so on, they are the ones that feel that they are my students and that is a source of tremendous satisfaction for me.

07-01:33:08

Burnett:

This is kind of segueing into your personal life a little bit. I want to talk about in the recent years. Can you tell us a little bit about family? You've talked about your children and grandchildren but there's another aspect to your personal life that I thought you might want to talk about.

07-01:33:31

Harberger:

I know where you're headed. So something like a year after Anita died I was visiting Carl Christ, whom we have mentioned already previously, a former colleague, fellow student, friend, all of that. And who was there but his sister-in-law Alice? Well, when he first got married Alice was working in New York and I was his colleague in Baltimore and he said, "When you go back to New Jersey to your parents, why don't you look up Alice?" So I looked up Alice and we had a few dates around New York and then she would come down to visit Carl and Phyllis and then we would have dates there. And by the time I got to Chicago in '53 she was already in Chicago working at the Merchandise Mart. And we had more dates starting then and she helped me furnish my coach house apartment because in the Merchandise Mart she had access to all kinds of discounts and good materials and so on. So anyway, we dated off and on all the way till New Year's, '56 to '57. That New Year's Eve was our last date. We never really went steady but we were steadily friends and even when I was going with another girl she would come over for dinner once a week, for example, Alice. And anyway, in May of '57 she got married to Dr. Howard Klevens,, who became her husband, a chemist from Pittsburgh. And in October of that year I met Anita at the apartment of [Sergio] De Castro, [Ernesto] Fontaine, and so on, and so we were separately married for many, many years. We saw each other a few times when I happened to visit Pittsburgh for a conference or something. I would stop by their house. Met her husband once, I think. Once I was there with Carl and Phyllis when her husband wasn't there, I think after he had died.

But anyway, in this reunion at Carl's house we decided to become traveling companions. And this is a sort of intermediate situation from living together permanently and just not seeing each other or just talking by phone or nothing. So anyway, she has traveled with me to Canada maybe five times. She comes at the end, the last week or so, of my stay with Glenn Jenkins and then after that we do something. We went to Montreal this last year. The year before we went to Argentina. One year before that we went to my brother's house to celebrate my ninetieth birthday, his eighty-fifth, plus his daughter's sixty-fifth and a thirty-fifth wedding anniversary or something. I called it the zero-

modulo-five party [laughter] because we had all these anniversaries, all divisible by five. But anyway, in June of this year we went to England and had a nice trip in England. And she spends at least part of the time on each of my visits to Clemson, which started in 2012 and continues to this day and I'm sort of a permanent visiting professor, like I was in Getulio Vargas Foundation. Did I tell you that story?

07-01:38:20

Burnett: A little bit, yeah.

07-01:38:24

Harberger: Carlos Langoni was head of Fundação Getulio Vargas at EPGE, the graduate school of economics and Mario Simonsen had been his predecessor. He became minister and so Langoni took over the EPGE. Every year I came as a visiting professor for six weeks or something like that and it got to the point where the elevator operators in the building called me *o professor visitante vitalicio*. [laughter]

07-01:39:16

Burnett: And *vitalicio* means?

07-01:39:15

Harberger: Means for life.

07-01:39:17

Burnett: For life. Hilarious. [laughter]

07-01:39:20

Harberger: With tenure. [laughter]

07-01:39:22

Burnett: With tenure. But Alice is a companion of yours now and you've rekindled this friendship and this association from a long time ago. That's extraordinary.

07-01:39:37

Harberger: You just can't imagine. If I imagine calling up one of these dating bureaus or something and being assigned to take somebody out—it seems so, I don't know, unreal. It's so much strain. You have to try to reveal yourself to such a person. You have foibles, you have weaknesses, you have this, you have that. How do you reveal all of that? Do you try to pretend—well, Alice and I knew each other well enough that all of that stuff was just implanted from the past. We didn't have to do any adjusting. [laughter] We are both crazy in our own ways but we know why the other one is crazy in that way and we accept each other's foibles and we have a fine time.

07-01:41:01

Burnett: Wonderful. Well, Dr. Harberger, I want to thank you again for taking the time to talk with me about your life and your career and the people you were associated with. I think this will be a rich addition to the history of economics and the history of international development and the history of economic

policy and the history of cost-benefit analysis and all of these things. So it's a real addition and I thank you for that.

07-01:41:31

Harberger:

Well, I want to congratulate you for what I think is a tremendously professional job that you have done through this whole exercise. I know how much you have read of background material to lead up to these things. But I can't imagine myself doing it. [laughter] So vast. And then you have so much of it embodied in your head after you've read it and you guide these interviews in a very deft and unobtrusive way. It's just a marvel to me how you're able to do that. I know you have had lots of experience at this but what can I say? It shows. [laughter]

07-01:42:44

Burnett:

Well, thank you. Thank you. Well, I think we should do more interviews with people in economics and I look forward to doing more interviews with folks. But this has been an extraordinary experience to talk with someone who has, despite your protestations to the contrary, a tremendous recall. I think you do remember a tremendous amount of detail of people you knew, of the economics you were thinking about, the process of your thinking, and that's going to give us a rich text for historians to draw from in the future, I think.

07-01:43:22

Harberger:

Thank you so much.

[End of Interview]

Appendix

CURRICULUM
VITAE**Arnold C. Harberger**

Professor of Economics, University of California, Los Angeles
(Emeritus since 2014)
and
Gustavus F. and Ann M. Swift Distinguished Service Professor,
Department of Economics, University of Chicago
(Emeritus since Oct. 1991)

Born: July 27, 1924; Newark, New Jersey
Marital Status: Married (Anita Valjalo, March 15, 1958); two
children

Education

Johns Hopkins University, 1941-43
University of Chicago, 1946-49; A.M. (International Relations), 1947
Ph.D. (Economics), 1950

Career Academic Positions

Assistant Professor of Political Economy, Johns Hopkins University, 1949-
1953 Associate Professor of Economics, University of Chicago, 1953-59
Professor of Economics, University of Chicago, 1959-76
Gustavus F. and Ann M. Swift, Distinguished Service Professor in Economics, University
of Chicago, 1977 - 1991
Chairman, Department of Economics, University of Chicago, 1964-71; 1975-1980
Director, Center for Latin American Economic Studies, University of Chicago,
1965 - 1991
Gustavus F. and Ann M. Swift Distinguished Service Professor Emeritus, University of Chicago,
1991 -
Professor of Economics, University of California, Los Angeles, 1984 -

Temporary Academic Positions

Research Assistant, Cowles Commission for Research in Economics, 1949
Visiting Professor, MIT Center for International Studies (New Delhi), 1961-62
Visiting Professor, Harvard University, 1971-72
Visiting Professor, Princeton University, 1973-74
Visiting Professor, University of California, Los Angeles, 1983-84
Visiting Professor, University of Paris, 1986
Visiting Professor, Institute for the Economy in Transition (Moscow), 2003

Consulting Positions — International Agencies and Foundations

Economist, International Monetary Fund, 1950, 1989, 2002-03
 Consultant, Committee for Economic Development, 1961-78
 Consultant and Lecturer, International Bank for Reconstruction and Development, 1963 -
 Consultant and Lecturer, Inter-American Development Bank, 1968 -
 Consultant and Lecturer, Asian Development Bank, 1971
 Consultant, Organization of American States, 1962-76
 Consultant, International Labor Organization, 1971-72
 Consultant, The Ford Foundation, 1965-76
 Consultant and Lecturer, Caribbean Development Bank, 1978

Consulting Positions — U.S. Government Agencies

Staff Consultant, President's Materials Policy Commission,
 1951 Consultant, U.S. Department of Agriculture, 1955
 Consultant, U.S. Treasury Department, 1962 -
 Consultant, U.S. Department of State (USAID), 1963-77, 1984-
 Consultant, U.S. Department of Commerce, 1965
 Consultant, U.S. Council of Economic Advisers, 1969-74
 Consultant, U.S. Department of Labor, 1976
 Consultant, U.S. Postal Service, 1976-78
 Consultant, U.S. Synthetic Fuels Corporation,
 1982

Consulting Positions — Foreign Governments

Consultant, Planning Commission, India, 1961-62; 1973
 Consultant, Ministry of Planning and Economic Policy, Panama, 1965-76
 Consultant, Central Bank of Chile, 1965-70
 Consultant, National Planning Department, Colombia (through Harvard Development Advisory
 Service), 1969-71
 Consultant, Office of Planning and Budget, Uruguay, 1974-76
 Consultant, National Planning Commission, El Salvador, 1973-75
 Consultant, Ministry of Finance, Indonesia (through The Ford Foundation, 1975; (through Harvard
 Inst. for International Development), 1981-82, 1986
 Consultant, Department of Regional Economic Expansion, Canada, 1975-77; Department of
 Migration and Employment, 1978-80; Department of Finance, 1981-83, Crown
 Management Corporation, 1985
 Consultant, Ministry of Finance, Bolivia, 1976
 Consultant, Ministry of Finance, Mexico, 1978-80, 1986, 1992, 1999-2003
 Consultant, Central Bank of Paraguay, 1982
 Consultant and Lecturer, Central Institute of Finance and Banking, Ministry of Finance,
 People's Republic of China (through The World Bank), 1983.

Consulting Positions — Foreign Governments (cont.)

Consultant, Joint Commission on Tax Reform, Government of Mexico, 1987
 Consultant, Ministry of Finance, Government of Malawi, 1988
 Consultant, Presidency of the Republic, Dominican Republic, 1989-97
 Consultant, Ministry of Finance, Government of Venezuela, 1989-90
 Consultant, Central Bank of Uruguay, 1990
 Consultant, Central Bank of Nicaragua, 1990
 Consultant, Ministry of Finance, Government of Colombia, 1991, 2002
 Consultant, Ministry of Economy, Argentina, 1994-2000
 Consultant, People's Bank of China, 1995
 Consultant, Central Bank of Ecuador, 1996
 Consultant, Government of Indonesia, 1997-2001
 Consultant, Office of the Economic Adviser to the President, Russian Federation, 2000-03

Honors, Awards, Board, etc.

Phi Beta Kappa
 Social Science Research Council Faculty Research Fellow, 1951-53; 1954-55
 Guggenheim Fellow (Universities of London and Cambridge), 1958
 Ford Foundation Faculty Research Fellow, 1968-68
 Fellow, Econometric Society
 Fellow, American Academy of Arts and Sciences
 Member, Board of Editors, *American Economic Review*, 1959-61
 Member, Board of Editors, *Journal of Economic Literature*, 1969-70
 Member, Research Advisory Board, Committee for Economic Development, 1966-68
 Member, Research Advisory Committee, Office of Scientific Personnel, National Academy of Sciences, 1961-65
 Member, Executive Committee, American Economic Association, 1970-72
 Doctor Honoris Causa (D.H.C.), University of Tucuman, 1979
 Special Ambassador, U.S. Department of State, 1984
 Named Honorary Citizen of San Miguel de Tucuman (Argentina), 1987
 Vice President, Western Economic Association, 1987-88
 Commissioner, International Commission on Central American Recovery and Development 1988-89
 Doctor Honoris Causa (D.H.C.) Pontifical Catholic University of Chile, 1988
 Doctor Honoris Causa (D.H.C.) Technological University of Central America, 1989
 Elected to membership in the National Academy of Sciences of the United States, 1989
 President, Western Economic Association, 1989-90
 Vice President and Chairman of the Advisory Board, Institute for Policy Reform, 1990-2000
 Member, Advisory Council, Institute for International Studies, Stanford University, 1991-99
 Vice President, American Economic Association, 1992.

Honors, Awards, Board, etc. (cont.)

Elected to Membership in the Chilean Academy of Social Sciences (as a Foreign Honorary Member), 1992

President, American Economic Association, 1997

Distinguished Fellow, American Economic Association, 1999

Simon Kuznets Memorial Lecturer, Yale University, 2000

Daniel Holland Medal, National Tax Association, 2002

Publications

Articles and studies in the fields of public finance, materials policy, economic theory, international trade, economic development and econometrics (see appended list for specific works).

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Arnold C. Harberger

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- "The Cornerstone -- The Model for 1975," in *Resources: From Abundance to Scarcity by 1975?* National Industrial Conference Board Studies in Business Economics, No. 36.
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- 1956 "The Changing Resources Picture," *Challenge* (February 1956): 15-19.

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"Issues Concerning Capital Assistance to Less-Developed Countries," *Economic Development and Cultural Change*, XX (July 1972): 631-40.

"Tax Policy as a Determinant of the Level and Structure of Exports." Paper presented at the Third Interamerican Conference on Taxation, Mexico City, September 3-8, 1972. Reprinted as "Politica tributaria como determinante do nivel e estrutura das exportacoes," in *Ensaio Sobre Cafe e Desenvolvimento Economico*, ed. by Carlos Pelaez (Rio de Janeiro: Instituto Brasileiro do Cafe, 1973): 487-506.

"Fiscal Policies and Employment Promotion," Joint Workshop on Employment Generation, New Delhi, August 2-7, 1972; organized by The Expert Committee on Unemployment in collaboration with The International Labour Office.

"A Note on the Main Goals of the Planning Process" (paper prepared for the Direccion General de Planificacion y Administracion de la Presidencia under the auspices of USAID/Panama).

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