COMMENTS ON ARNOLD C. HARBERGER,
"ON MAKING THE MOST OF THE AVAILABLE RESOURCES"

by

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This paper was presented at the meetings of the
Joint Allied Social Science Associations
in Chicago,
December 27, 1958

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(American Economic Association, December 27, 1958)

It is comforting to find that the postwar concentration on economic development is beginning to produce a body of received doctrine. Dr. Harberger's description of the symptoms of underdevelopment fits my own field experience, and I find myself in hearty agreement with his two main conclusions: first, misallocation of resources, in the sense of a divergence from what would result from the free play of market forces under conditions of pure competition, is a minor aspect of the problem of poverty in underdeveloped countries; and second, the hope for "spectacular growth" lies in "improving the quality of the labour force and in accelerating the rate of adoption of cost-reducing innovations." I also approve most heartily his efforts at quantification; the major gaps in our knowledge of underdeveloped countries are still the empirical ones. I am less certain than he that significant upgrading of the labour force can be achieved without adding to the stock of tools and equipment and improving their quality; but this is a question of fact about which it would be fruitless to argue without documentation.

What disturbs me about Dr. Harberger's paper is that "he doth protest too little." His recipe for economic growth is: eliminate monopolistic, political, and capricious intervention with the free
forces of the market, and accelerate the application of the best known
techniques. My own view is that "misallocation" a la marginal calculus
is not only quantitatively unimportant, but is very nearly irrelevant
to the development problem. I am convinced that Harberger's recipe
will not work unless it is accompanied by drastic structural change,
involving wholesale transfers of population from peasant agriculture
to industry, which market forces alone and unaided will not produce.
Such transfers require simultaneous industrialization and agricultural
revolution, and so necessitate substantially increased capital accumu-
lation and government intervention in the allocation of resources.

Techniques in the industrialized sectors of many underdeveloped
countries already compare favourably with those of the advanced
countries. What demarcates advanced countries is the ability to feed
the populations well, and in some cases even produce exportable sur-
pluses of farm products, with 10 to 20 per cent of the labour force.
The techniques that make possible this high productivity in agriculture
cannot be applied on the splinter holdings typical of peasant agriculture.

I am inclined to think that "patching the market" will accomplish
even less than Harberger estimates, because I do not regard "intervention"
as "distortion." Harberger talks of a "poorly organized and disequilibrated
labour market"; of credit rationed according to "whims of bankers"
rather than going to the "highest bidders" so that "high-payoff uses
of credit are denied adequate funds"; his diagrammatic analysis of the
costs of tariffs implicitly assumes that pure competition prevails in the economy and that the purely competitive equilibrium position is optimal; he talks as though any "artificial restraint or market imperfection" involves social loss; he speaks of "new taxes" as "distortions" and of "capricious policies" which interfere with "the natural forces of adaptation." All this leaves the impression that the market left to itself works very well. I would not for a moment deny that bad policy can make the market work even worse than it would when left to itself; but I would deny vigorously that the market by itself will produce rapid economic growth in underdeveloped countries.

The present economic position of underdeveloped countries is for the most part the result of individual, marginal, market decisions. Government intervention had relatively little effect on the pattern of development between the Napoleonic Wars and World War I. Nor was monopolistic distortion particularly marked. Nothing approaches the purely competitive ideal more closely than peasant agriculture. True, the industrializing sectors (including plantation agriculture) were not purely competitive; but they may have been as close to it as technical efficiency permitted. To have had a thousand oil companies in Indonesia and a thousand chrome mining companies in the Philippines would have been patently absurd. The plantations were competitive in the product market most of the time. They were monopsonistic in the domestic market for labour; but since the long-run supply of unskilled labour
to the industrializing sector was perfectly elastic, and the cost of training fairly constant, the equilibrium position was little affected by monopsony power. When properly cast in terms of time and scale, the Arthur Lewis argument on this point is right. Population growth—which industrialization accelerated—assured to the industrializing sector all the labour it could absorb at wages just above the village norm. And it was the "monopolized" industrial sector that expanded, not the "competitive" rural sector.

Thus we must look elsewhere than at market imperfections for the explanation of underdevelopment. I have found it mainly in the "population explosion" and "technological dualism"—at least for Asia. Technological progress in the past has been accompanied by accelerated population growth. It probably will be again in these countries, although for somewhat different reasons. The sector where investment was concentrated was capital-intensive, providing far too few new jobs for the increasing population. The additional numbers were absorbed into the peasant-agriculture-and-small-industry sector, where coefficients were variable. Productivity and incomes in this sector consequently failed to rise, and in some countries may even have fallen.

Another part of the explanation lies in lumpiness, indivisibilities, discontinuities, and external economies: indivisibilities of demand stressed by Rosenstein-Rodan and Murkse; the lumpiness of capital, especially social overhead capital; discontinuities in the savings function;
and most important, discontinuities in the investment function. Each of one thousand investment projects may properly be rejected by one thousand entrepreneurs in terms of their own marginal-cost-returns calculations; yet all thousand together may launch a substantial and sustained increase in national income. The relative marginal productivity of various projects may vary considerably according to the sequence in which they are carried out and the other projects with which they are combined.

Still another part of the explanation lies in what Myrdal calls "backwash" effects of development concentrated in one sector or region of the economy. Thus expansion of foreign trade may bring growth to the industrial sector while further retarding the rural sector.

Dr. Harberger recognizes these factors, but does not take the logical next step. He does not insist that net investment of less than say ten per cent of national income is unlikely to permit technological progress rapid enough to outrun population growth, bringing discernible changes in per capita income, and the changes in attitudes and behavior patterns needed for self-sustained growth. If we are concerned with the design of investment programs absorbing ten to fifteen per cent of national income, marginal returns to individual investment projects, taken by themselves, are unimportant. A calculus is still involved and the consumer is not dethroned as sovereign; but the question is not, "Which project by itself will bring the biggest increase in output, relative to
cost, during the next few years?", but "Which pattern and sequence of projects during the next five years will bring the most rapid growth of national income during the crucial period—say, in the decade beginning ten years hence?" This question breaks down into such hard-to-answer sub-questions as, "What investment program will have the maximum aggregate 'linkage,' backwards and forward?" (to use Albert Hirschman's happy term for the effects of one investment on investment in earlier and later stages of the production process); What kinds of investment will create pressures of a kind that will assure the undertaking of further investment? Which will bring the most improvement in labour, managerial, and technical skills? Which will contribute most to technology-mindedness and development-mindedness? Which will do most to shift entrepreneurs from "zero-sum games" to "positive-sum games?" (Leibenstein's expression).

When evaluated in terms of this kind of analytical framework, what appears at first sight as "showcase psychology" may turn out to be wisdom, and what looks like "caprice" may reflect sound intuition. Thus Hirschman has shown, on the basis of work done by Chenery and Watanabe, that iron and steel seems to have higher aggregate linkage effects than any other industry. Perhaps the universal wish among underdeveloped countries for iron and steel plants rests on a sound foundation.

I have a hunch that if Dr. Harberger and I were on the same advisory team we could agree on the advice to give a specific government
at a particular time; but the analytical framework I consider appropriate for underdeveloped countries does not lead to general policy recommendations of the kind given in Harberger's paper. With regard to taxes, the real problem is, "How to collect more revenue without diluting incentives needed for development?" In my view import policy should be discriminatory, according to the development plan; multiple exchange rates are one of the most effective devices for improving resource allocation--provided the system does not become too complicated. Producers with monopoly power should not be "continuously subjected to foreign competition." Something like Hirschman's "strategy" is preferable; let imports come in freely until the domestic market is wide enough to be attractive to domestic enterprise, and then protect the infant industry. And even if one could determine "marginal productivity of capital in the private economy" (is it the 100% that lenders earn on credit to peasant farmers, or the 10% that foreigners earn on mining and petroleum?) it should be shunned as a guide to the allocation of public investment funds.