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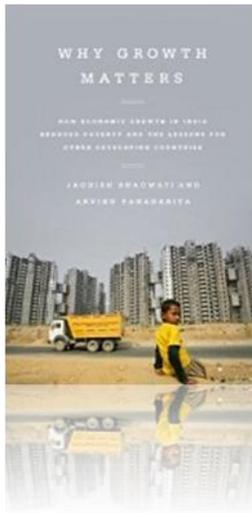


Obra Social "la Caixa"



# Why Growth Matters: How Economics Growth in India Reduced Poverty and the Lessons for Other Developing Countries

**Bhagwati, Jagdish & Panagariya, Arvind, (2013), Public Affairs, New York.**



*“Redistribution, as distinct from growth, cannot be the answer to removing poverty.”*

*“Growth works its twofold magic: through a happy and necessary marriage of economics and politics.”*

*“Productivity growth requires moving workers from low-productivity agriculture into high-productivity industry and services and from the informal to the formal sector within industry and services.”*

*“The preferred policy mix consists of unconditional cash transfers for most needs, vouchers for elementary education, and insurance for major illnesses with government covering the premiums.”*

## Summary

India’s growth appears to have ground to a halt. Two renowned professors at Columbia University blame this on successive governments’ failure to carry out the reforms needed to boost economic growth, which is the only way of relieving the poverty that afflicts much of the country. Nevertheless, since the 1991 Asian Crisis and the rise of China (India’s direct rival in the region), India has shown signs of reacting and of seeking advantages conferred by its long democratic tradition. Mould-breaking reforms may yet open its market to the world and turn India into a model of development for other emerging economies.

The aim now is to achieve a fairer, more effective distribution of income and to overcome a diverse range of thorny problems such as boosting employment, improving health and education systems and ensuring sustainable production. This all involves scrapping old ways of doing things and dispelling the many myths about India that scholars and analysts still trot out. Bhagwati and Panagariya try to overcome these prejudices and insist on the need to relax the Indian government’s iron grip over the economic system and to work with private capital so that the nation can get back on the growth track begun in the early 1990s. The authors argue that only economic

growth led by the markets and overseen by a government with liberal policies can improve living standards for the 600 million Indians still living in poverty.

## The authors

**Jagdish Bhagwati** is Professor of Economics at the University of Columbia and member of the US *Council on Foreign Relations*. He has combined research work with public policy and has written numerous articles in the world's leading publications. Bhagwati has written various books and received many awards. He is considered to be a pioneering intellectual in India's reform movement.

**Arvind Panagariya** is Professor of Indian Economics and Economic Policy at Columbia University. He also works as a non-resident researcher at The Brookings Institution. He was formerly Head Economist at the Asian Development Bank. Panagariya has drawn up a large part of the recent reforms in India and has written a score of books, as well as editorials for *Foreign Affairs* and *Foreign Policy*. Panagariya writes an influential monthly column in *The Times of India*.

## Key ideas and opinion

Jagdish Bhagwati and Arvind Panagariya are two of the brains behind India's reforms over the last few years. For this reason, the book may be considered a **Bible for political leaders not only in India but also in all developing nations seeking to cut poverty and take the path of sustainable development**. The authors begin their analysis with India's independence in 1947. From then on, Jawaharlal **Nehru's** idealism and above all, the socialism of his daughter **Indira Gandhi** drew up a model of the state whose economic policies hindered productivity. The country languished in the economic doldrums as the government exercised iron control over private investment and production, fostered public monopolies in all fields, and generally pursued a trade policy which obsessively pursued self-sufficiency and limited foreign investment. This approach delayed much-needed reforms for years and it was only in 1991, in the middle of the Asian economic crisis, that the Indian Government finally grasped the nettle.

Given the measures taken over the last two decades, the **authors are optimistic that India is taking a path that will lead to economic growth. Such growth is the only way to reduce poverty in India**. Yet this challenge is viewed with scepticism and in this case, Bhagwati and Panagariya note the tendency of left-wing economists such as Joseph **Stiglitz** and Amartya **Sen** to consider market forces as evil and to oppose the privatisation of certain public services. In the authors' view, such privatisation is vital in India. **They consider that left-wing analysts distort the notion of poverty and foster myths on India**. The first part of the book attempts to dispel these myths with

empirical data and through a thorough summary of the economic reforms carried out in India since independence. In the second part of the book, the authors review the two stages of Indian reforms since 1991 — reforms that are still underway today.

## Myths on Indian reforms

Bhagwati and Panagariya focus their analysis on myths concerning development strategies, inequality, growth and poverty. Here, they take to task those who argue that India's market liberalisation measures have harmed the country's health and education systems, boosted suicide rates among farmers and fostered corruption.

**The authors refute arguments such as: (1) growth is not needed to relieve poverty because income redistribution could achieve this aim; (2) India's growth plans have not taken poverty into account.** They painstakingly review India's development plans since Independence, showing that each policy took specific measures to improve the lot of the have-nots, with sections on subsidized health and education. The success of these policies was patchy but — argue the authors — this does not excuse the omission of such initiatives in some scholarly accounts.

The same scepticism re-emerged in 1991, with the reforms carried out by Prime Minister P.V. Narasimha, spawning new myths which — in the authors' view — have only served to hinder India's modernisation. Critics argue that the reforms did not spur India's economic growth from 1991 onwards but rather that **the country's economic recovery actually began in 1980** and that it was largely due to a change in attitude. The authors counter that growth in the 1980s was fairly modest **(4.6% per annum) compared with 5.8% in the 1990s, which rose to 8.2% in the first decade of the 21<sup>st</sup> century.** It has also been said that the reforms did not reduce poverty, but the authors use empirical data to show just the contrary: **while half India's population lived under the poverty line in 1978, only one fifth do so today. This means two hundred million Indians have escaped from poverty.** This overturns the idea that opening the markets has made poverty worse and widened the social divide. **Bhagwati and Panagariya categorically reject the popular notion that globalisation is bad for the poor.** Here, the authors recall that two of India's poorest regions — Bihar and Orissa — are also the ones that have experienced greatest economic growth.

Corruption is another deep-rooted evil in India and some argue that the 1991 reforms only made things worse. By contrast, the authors argue that this overlooks the fact that **corruption only became rampant under Indira Gandhi, when the state began to control the entire economy.** In 1991, companies and citizens were given greater freedom, thus reducing the scope for corruption. Recent cases of corruption are, the authors contend, merely a response to the host of opportunities opened up in fields in which reforms have yet to take effect.

## Reforms: Stages 1 and 2

Bhagwati and Panagariya distinguish two stages of reform. The first focuses on spurring growth and cutting poverty. The second centres on health, education, and employment in rural areas and is made possible by higher revenues. The second stage is underpinned by the first one, which though well-advanced, still has some way to go if it is to provide the foundations for future reforms. There are many strands in this strategy for reducing poverty but the main one is economic growth. **The two-phased programme arises from a necessary link between economics and politics and is a model that India can export to other countries.**

### *Stage 1: Sustainable, inclusive growth*

**The first stage focuses on sustainable, inclusive growth** and smoothes the path for the second stage, which optimizes income redistribution programmes and enlarges the scope. For the authors, **the first stage is still in progress and the scope for growth has not been fully exploited.** The reduction in poverty stemming from higher wages and job opportunities still has a long way to go, and productivity remains subpar. It is therefore a question of concluding this first stage so that India can create greater scope for social inclusion in the second one. To achieve this, **some key measures involve moving workers out of the low-productivity agricultural sector and into the industrial and service sectors and out of informal jobs and into formal ones.** In this respect, the main problem is that entrepreneurs do not hire unqualified workers — of which there are many in India. According to the authors, this practice is attributable to slow growth and productivity in labour-intensive manufacturing industry. To solve the problem, Bhagwati and Panagariya press for further reforms, such as those for opening up the country to foreign corporate investment.

Another barrier to development is **the surfeit of labour laws (up to 150 at the state level) which over-protect workers, paralyse production and create confusion.** Many firms are overwhelmed by the sheer number of laws and therefore do not know what their duties are, which sometimes leads to free interpretation and corruption by work inspectors. The current laws, most of which date back forty years, are also unreasonably strict with employers. For example, **it is almost impossible to fire even the most unproductive worker.** Moreover, entrepreneurs prefer to keep their firms small, seeing as **legislative costs increase in proportion to the number of workers employed.** This is worth the trouble if the company is very large but such costs have led to the virtual disappearance of medium-sized firms. **Reforming the labour legislation is therefore a priority,** especially the *1947 Industrial Disputes Act*, which makes hiring workers very expensive and so makes it hard for firms to expand.

**Land purchases are based on an Act dating from 1894 which badly needs amending,** particularly its definition of social purpose — which determines whether the land may

be purchased – and the price paid. Many farmers are vulnerable because they do not know their legal rights.

Last, education reform must facilitate large-scale modernisation and product innovation. **Education in India falls to private institutions but it is the state that decides which new institutions may open. According to the authors, this needs to change to allow greater choice.** The reservations on foreign universities opening campuses in India deprives would-be Indian students of education options otherwise unavailable to them.

### *Stage 2: Income redistribution, Health, Education*

Once the foundations for sustained growth have been laid (during the first stage), India could get to grips with **effective income redistribution, covering the whole population.** The strategy proposed by Bhagwati and Panagariya for this second stage of reforms is based on **mixed policies: money transfers without strings attached to meet most needs and thus reduce corruption; primary education vouchers to ensure money is spent where intended; insurance for serious diseases based on government coverage of contributions.** The authors also prefer selective to universal coverage, for which exclusion criteria might be based on say possession of a motorcycle, land or other such goods. This, they argue, would ensure that the poor's needs would be adequately met.

In this chapter, the authors discuss malnutrition, and arguing that **it is a common mistake to consider hunger just in terms of calories and that this leads to misinterpretations.** The required calorie intake depends on a person's height, weight and occupation. **The correct measure of poverty should be based on each individual's calorie needs,** and meeting these needs can only be achieved through economic growth and income redistribution. Accordingly, the authors suggest **subsidies be replaced by direct transfers to avoid 'leakage' through the distribution chain and to do away with the vast bureaucratic expense incurred in administering the present system.**

With regard to the **health system,** the authors recall the advances India has made in reducing infant and maternal mortality and lengthening life expectancy. Even so, they note that the health system has grave problems and call for reforms in the following five fields: public health, routine medical care, hospital treatment and out-patient surgery, human resources, and supervision of the health system. To these ends, they propose **setting up an independent agency** specialising in health and with its own budget. Furthermore, the authors suggest that **patients should be given the money to manage their own routine medical care, forcing state health provision to compete with private suppliers and letting market forces balance supply and demand.** These direct transfers to citizens should have no strings attached but ought to foster a healthy life style to keep visits to the doctor's surgery to a minimum. The **cost,**

although we are speaking of 600 million people, is not as high as one might think: **500 rupees per person comes to a total of 300 thousand million rupees — just 0.38% of India's GDP.** Last but not least, the health service needs to **replace the many unqualified medical staff** (a problem common in rural areas). More well-trained medical staff are needed to ensure an effective, sound health system.

Furthermore, these second-stage reforms should include **primary education**, which is a field in which economic growth brings direct benefits. In India, there are various recognised state schools for the elites but there are also a huge number of schools that are not recognised and that have ramshackle facilities and unqualified teachers. However, the biggest group comprises private schools, of which India has hundreds of thousands. Unlike the state schools, their teachers are held accountable for their actions and thus provide students with a much better education. **Given the lack of a good state school system, education vouchers are the best option, enabling parents to send their children to the private school of their choice.**

## Proposals for the future

Bhagwati and Panagariya **praise the measures taken by former Prime Minister Narasimha Rao and his economics minister, Manmohan Singh**, to get India out of the doldrums. **They scrapped customs barriers, allowed the entry of private capital in airlines and telecommunications, tweaked direct and indirect taxes and scrapped small-company monopolies for a wide range of manufactured goods.** The authors stress the enormous impact of these and other initiatives in increasing growth and reducing poverty.

**This gives various reasons for optimism over the medium and long term.** One of them is that the public has become convinced of the benefits of the reforms for India. This has put **an end to the kind of anti-reform protests seen in September 2012.** Demonstrations are now against corruption, not against the new measures. There are also objective reasons for supporting the reforms: **growth depends on savings (and investment) yields, and these now account for 33% of India's GDP.** With regard to productivity, India has opened up to the world economy. Many Indians now occupy senior positions in multinational companies — something that pays handsome dividends through various channels and shows India in a good light. Last but not least, the authors stress that **the recent economic slow-down has focused everyone's minds on growth for once and for all** and has convinced many that this is the only way to effectively reduce poverty.