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Which Way India? The Bhagwati–Sen Debate and its Lessons

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Jagdish Bhagwati and Arvind Panagariya, *Why Growth Matters: How Economic Growth in India Reduced Poverty and the Lessons for Other Developing Countries*. New York: Public Affairs, 2014, pp. 280, US$28.99.

Jean Dreze and Amartya Sen, *An Uncertain Glory: India and its Contradictions*. Princeton: Princeton University Press, 2013, pp. 448, Paperback US$19.95, Hardcover US$29.95.

Joan Robinson, the Cambridge economist, is said to have once quipped that 'whatever you can rightly say about India, the opposite is also true'. Perhaps nothing so vividly highlights this incongruity than the books by eminent economists: Jagdish Bhagwati and Arvind Panagariya in *Why Growth Matters: How Economic Growth in India Reduced Poverty and the Lessons for Other Developing Countries* (2014); and Jean Dreze and Amartya Sen in *An Uncertain Glory: India and its Contradictions* (2013). As expected from such renowned scholars, their books use an impressive range of statistics and sound economic reasoning to offer a wealth of insights and information on the Indian economy, and eloquently analyse past and current economic policies on growth and development with huge relevance for India. Unfortunately, the books' substantive messages, including the policy prescriptions, have often been overlooked amidst the acrimonious war of words between the two towering protagonists—the more pugnacious Bhagwati, a distinguished Columbia University professor of economics and a leading candidate for the Nobel Prize, and the more reticence Sen, already the winner of the Nobel Prize in economics and professor of economics and philosophy at Harvard University.

The aim of this review is to retrieve and highlight the substantive messages and salient insights that have been overlooked. As the following pages illustrate, although the two books present, at times, passionately contrasting views on India's post-independent economic achievements, in particular what explains the successes, the failures, the missed opportunities and what should be done to boost India's economic growth and alleviate poverty, their ideas also converge on some key issues, and the differences between Sen and Bhagwati are not always as pronounced as it is often made out to be. In fact, contrary to the claims of partisans and detractors on both sides, Bhagwati (and Panagariya) is hardly a cheerleader of business and corporate interests, nor wedded to some orthodox 'neo-liberalism', and nor is Sen (and Dreze) representative of some quasi-socialist and pro-government Keynesian economics. More to the point, Sen is not against economic growth and Bhagwati is not against the provision of public assistance and reducing poverty. The works of these eminent scholars are too sophisticated and nuanced to be caricatured in such a crude way. Rather, their disagreements and debates are old and enduring ones in political economy: the proper role of the market and the state in economic development and how best to balance these two forces. Indeed, as the following sections show, the debate often comes down to whether one sees the proverbial glass as half-full or half-empty.

The Broad Convergence

When India gained independence in 1947 after centuries of colonial rule, it was amongst the world's poorest country. Over 70 per cent of its population lived mired in extreme poverty and destitution; hunger and malnutrition was widespread; and the resulting stunting and wasting took a heavy toll on the living. Not surprisingly, life expectancy was a mere 30 years, child and infant mortality was high, illiteracy was prevalent and social services largely non-existent. Both Bhagwati and Panagariya (B–P) and Dreze and Sen (D–S) agree that successive governments in independent India have done a remarkable job in overcoming some of the worst legacies of colonialism. As D–S aptly note:

> On the economic front, even though the growth of the Indian economy was quite slow—about 3.5 per cent annually—for several decades after independence, this slow growth was nevertheless a very large step forward compared with the near-zero growth (and at times even economic decline) that occurred in the colonial days. This prolonged economic stagnation ended as soon as the country became independent. (p. 3)

Yet, both B–P and D–S also share the conviction that the successive governments of independent India could have done much more to generate higher gross domestic product (GDP) growth, alleviate poverty and improve overall living standards—or what Sen (1999) has labelled 'human capabilities'. More specifically, both agree that the slow (and stagnant) 'Hindu rate of growth' of around 3.5 per cent per annum (which barely kept up with population growth) for the first four-and-half decades after independence—which they attribute mostly to governmental regulatory distortions and rent-seeking created by the corrosive top-down statist 'license permit-raj regime'—severely stifled India's economic performance and ability to improve socio-economic conditions for its citizens to the levels achieved by the fast-growing East Asian economies. As B–P succinctly note, 'A lack of awareness of the importance of health and education or the absence of good intentions was not behind the slow progress in these areas. Instead... progress was inhibited by slow growth' (p. 18).

Both B–P and D–S agree that sustained economic growth is an essential precondition to prosperity. Without first (and constantly) making the economic GDP pie bigger, that is, creating more wealth, development and improvements in human welfare and redistribution cannot take place. Hence, both acknowledge that the dismantling of some of the worst features of the 'permit license-raj' system and its replacement with a more market-friendly regime (in Indian lexicon, 'economic liberalisation'), in the early 1990s, helped to jump-start economic growth and improve living standards. Citing official data, B–P reiterate that India's sustained GDP growth rate, averaging about 7.5–8 per cent a year over the two decades, helped reduce the proportion of people with incomes below the country's official poverty line from 45 per cent in the early 1980s to around 28 per cent in 2005. In other words, sustained growth in the post-reform period has lifted over 250 million Indians out of destitution and poverty. Equally impressive, the fruits of growth have been broadly shared, including among the historically disadvantaged and poorest groups such as the 'Scheduled Castes' and 'Scheduled Tribes'. Although D–S acknowledge that the overall poverty rate has declined, they also caution that not only the country still harbours widespread and acute poverty, but also the extent of the 'official' poverty decline should be taken at face value given the abysmally low official 'poverty line' threshold. They also contend that growth has not been 'inclusive'. Rather, it has benefited some groups more disproportionately than others.[1]

The Divergence

As unabashed proponents of open markets and deeper global economic integration (via opening the economy to foreign investment, trade and competition), B–P have long blamed the interventionist and 'inward-oriented' Indian state for undermining economic growth. As the title of their book so clearly illustrates, 'Growth Matters' because without sustained economic growth there simply will not be enough wealth and opportunities generated for individuals to improve their living conditions, nor will there be sufficient resources for governments to invest in services such as education and health care, including 'inclusive growth' to improve the 'human capabilities' so dear to S–D. Thus, B–P note that:

> [G]rowth would create more jobs and opportunities for gainful improvement in income directly pulling more of the poor above the poverty line and additionally would allow the government to pull in more revenues, which would enable the government to spend more on healthcare, education, and other programmes to further help the poor. (p. 27)

Although, B–P reiterate the conventional view that economic growth tends to raise inequality initially, they also remind that once on a sustained path, growth will eventually generate enough resources for the state to finance its social and redistribute programmes, including opportunities to mitigate the effects of the rise of initial inequality.

Specifically, in order to avoid putting the cart before the horse, B–P cogently argue that two distinctive stages of reforms (what they refer as 'Track I' and 'Track II' reforms) are necessary for sustainable long-term economic growth and development. In the initial phase, Track I reforms should put in place policies designed to generate strong and sustainable GDP growth. Once growth takes off, Track II should focus on a fairer redistribution of the wealth generated through Track I reforms, including greater public investments in health care, education, sanitation and other needed social services. They warn that without such proper sequencing, the growth process will remain highly volatile and unpredictable and fail to produce the desired economic and social welfare outcomes. To B–P, sustained economic growth by creating more opportunities provides motivated and enterprising individuals the means to pull themselves up by their own initiatives. That is, growth by raising incomes sufficiently will, in the process, not only enhance individuals ability to provide for themselves and their families the basic necessities of life, but also the means to invest in their educational, medical, nutritional and other socio-economic needs. Therefore, B–P argue that if India is to sustain its growth momentum—and in the process bring more of its people out of poverty—the pace and depth of economic reforms must be accelerated. They note that market reforms, or 'liberalisation', in India remain an 'unfinished business' and a significant and continuing drag on growth. For example, B–P compellingly point out that excessive regulations in the manufacturing and industrial sectors (in the form of some 200 cross-cutting and punitive national and state-level labour laws), coupled with restrictions on primary sectors such as land and energy, have not only constrained needed investment in these important sectors but have also severely undermined job creation in the formal economy, in particular labour-intensive manufacturing.[2] Indeed, B–P caution that without deeper reforms, India (unlike China and the erstwhile fast-growing Asian economies) is in the danger of effectively bypassing the critical manufacturing stage—by transitioning from an agricultural-based to a service-oriented economy—with huge negative consequences, as the service sector has a limited capacity to generate labour-intensive employment as compared to the manufacturing sector.

Although D–S acknowledge that sustained economic growth is essential if there is to be meaningful investment for human capabilities and resources for redistribution, unlike B–P, they do not see growth as the panacea for all of India's economic woes, nor do they believe that redistribution and investment in human capabilities must precede growth. Indeed, they vociferously reject the idea that a 'trade-off' exists between growth and more equitable distribution. To the contrary, they claim that both can and must take place simultaneously. This is because D–S (unlike B–P) remain deeply sceptical that the so-called open and 'free' market will automatically or magically—like the proverbial rising tide—lift all boats. To the contrary, they point out that GDP growth, in itself, does not necessarily translate into an equitable distribution of incomes. Rather, they claim that evidence shows that the growth process, if left unchecked, hardly trickles down deep and wide enough to benefit everyone, and over two decades of India's post-economic liberalisation experience confirms that not only the fruits of growth have been inequitably distributed (and have further exacerbated inequality), they have also failed to meaningfully improve the lives of the majority of Indians as many of the age-old 'deprivations' and 'humiliations' continue to persist. They caution, 'India has been climbing up the ladder of per capita income while slipping down the slope of social indicators' (p. 8).

More specifically, D–S point out that despite the fact the Indian economy grew at a robust 10 per cent annually (second only to China) for a decade before the global financial crisis, this sustained high growth rate failed to lift everyone. Rather, the major beneficiaries have been India's privileged classes—the business elite and the rapidly expanding middle class—who have seen a significant increase in their incomes, wealth, purchasing power and living standards—comparable to levels attained in the advanced economies. However, this growth has failed to reach hundreds of millions of Indians who have hardly seen any noticeable improvements in their lives. This is because even during the highest growth period in India (2002–2008), there was very little employment growth—underscoring D–S argument that high growth does not necessarily translate into higher employment. D–S tellingly point out that the living standards of at least one-third of Indians (approximately 350–400 million people) are not much better than the poorest people in sub-Saharan Africa—a continent that is much poorer than India in terms of GDP per head. They provide some sobering information: every year in India, some 1.7 million children under the age of five die from preventable diseases such as diarrhoea; and out of those who do survive, some 48 per cent are stunted for life as a result of lack of good nutrition and preventive health care. In fact, the rate of infant mortality in India is the same as in Africa, but malnutrition rates are much higher in India than in sub-Saharan Africa. What is even worse, India is not just an outlier among the emerging Asian countries; it is also falling behind much poorer nations like Bangladesh and Nepal. For example, D–S point out that although Bangladesh's per capita income (at purchasing power parity) is less than half of India, life expectancy in Bangladesh is higher by four years (69 years to 65 years in India); the child immunisation rate is 96 per cent compared with India's 73 per cent; and access to improved sanitation is 56 per cent compared with India's dismal 34 per cent. For D–S, democratic India's gross neglect in not making the necessary investments in food, health, sanitation and education of its people, in particular the children, is simply 'unforgivable', 'scandalous' and 'shameful', as it has prevented millions of Indians from achieving their full potential and living productive lives.

According to D–S, the major reason behind India's poor underperformance in these critical sectors is due to the grossly inadequate levels of public expenditure. To D–S, this only confirms that governments, including democratic ones, even when they have enough funds will not necessarily spend it on the poor. In the case of India, much of the new wealth has gone towards subsidies—whose major beneficiaries have been the well-to-do. Not surprisingly, India's poor outcome in health is directly related to the fact that it only devotes a paltry 1.2 per cent of GDP to health compared to China's 2.7 per cent (p. 37). Nevertheless, they argue that the state can play a positive role. Specifically, governments should not only enforce laws to ensure equal opportunity and access but also make the needed investment in human capital or 'social infrastructure' to empower individuals with skills so that they can help themselves, their families and the larger society. Moreover, it is also appropriate for the state to directly intervene to assist the most marginalised and vulnerable populations via public-funded programmes to generate employment, including targeted and subsidised spending to provide for basic human needs like food, education, health care and social security. Indeed, D–S forcefully argue that experience from different parts of the world vindicates their view that active and targeted public policies are essential to ensure that the fruits of economic growth are as widely shared as possible and that public investment in health care and education pays long-term dividends for the society. They claim that the 'Kerala Model' (reference to the southern state of Kerala) can serve as an experience for others to emulate because its investment in 'human capabilities' has enabled a relatively poor state (in terms of natural resource endowments) to achieve First World literacy rates and health outcomes, including significant improvements in well-being and life expectancy.

Not surprisingly, B–P strongly disagree arguing that Kerala's success is due to years of sustained growth (largely the result of remittances sent home by Keralites working abroad) and massive private investment on education and health (the highest in India), rather than the state-driven redistribution.[3] For B–P, the 'Gujarat model' (ushered in during the tenure of the then Chief Minister Narendra Modi), by focusing on economic growth and private entrepreneurship, has produced far better socio-economic and welfare outcomes than that of Kerala. Indeed, Gujarat has been India's fastest growing state, notching double-digit growth rates over the past decade. In 2011–2012, the state's GDP grew at 8.5 per cent compared to the Indian economy which grew at around 5 per cent. During 2000–2013, Gujarat received approximately US$ 8.8 billion in foreign direct investment (FDI), or 4 per cent of India's total FDI during the same period. B–P persuasively note that the Modi administration by creating a conducive environment for business (especially its openness to both foreign and domestic investment and trade) and due to its ability to provide good governance (Gujarat being the 'least corrupt' state in India), helped in Gujarat's exceptional economic performance, including impressive record on poverty reduction and 'human capability' indicators such as the rapid improvements in literacy rates, sanitation and rural electrification. B–P forcefully stress that it is the sustained economic growth which has made redistribution and improvements in living standards feasible in Gujarat, not the other way round.

Not surprisingly, the two books present sharply divergent assessment of the flagship Mahatma Gandhi National Rural Employment Guarantee Act (MGNREGA) passed into law in 2005. The programme guarantees every rural household the right to 100 days of rural-based employment at the prevailing minimum wage.[4] B–P, rather curtly, dismiss the US$ 6 billion a year MGNREGA programme as an expensive palliative and symbol of government waste and incompetence—through outright siphoning via layers of corruption and poor delivery and implementation. Their careful calculation shows that MGNREGA (after factoring in corruption and waste) spends about ₹248 in order to deliver a net ₹50 per person per day. In other words, the entire scheme is highly inefficient and costly as it takes about ₹5 to deliver ₹1 worth of benefits. According to B–P, the poor would have benefited far more from 'direct cash transfers' because cash transfers have two distinct advantages over 'in-kind transfers'. First, they empower the recipient rather than placing them at the mercy of an array of middlemen, as is the case under in-kind transfers; and second, they are more efficient as they cut corruption and leaks in the long distribution chains typical under in-kind transfers. B–P note that because direct electronic transfer of payments to beneficiaries through the Unique Identification Authority of India's (UIDAI) Aadhaar card-enabled bank or post office accounts will reduce bureaucratic red tape, corruption, government expenditures and improve overall societal outcomes, it is now prudent to transit out of all in-kind government transfer programmes, including health and education services, under a 'conditional' cash transfer or voucher system.

Although, D–S are not necessarily averse to the idea of direct cash transfers, they remain cautious with regards to direct cash transfer of food subsidies, because they, quite correctly, note that direct access to food usually benefits the most vulnerable in society, in particular female children. This is because evidence shows that when the subsidy is given directly as cash, it tends to mostly benefit young males given the deep-rooted male bias in the Indian society. Moreover, they note that it is irresponsible to suggest that cash transfers in contemporary India can replace public services by giving appropriate incentives to recipients to purchase health and education services from private providers. To D–S, such views are based on a gross misunderstanding of the experiences of few Latin American countries. They point out that in some Latin America countries (namely, Brazil, Chile and Mexico), conditional cash transfers have served as a complement, not a substitute, for public provision of health, education and other basic social and welfare services. The incentives work in these countries because the basic public services are there in the first place. For example, in Brazil and Chile, basic health services such as immunisation and antenatal care are now universal. Unfortunately, these basic services are still largely absent in India—so cash transfers in such settings will not be effective. In regards to MGNREGA, even as D–S acknowledge the myriad problems that plague it, they nevertheless argue that the programme has also produced many positive outcomes. Namely, by providing the rural poor employment during periods when no other work is available, MGNREGA serves as a crucial 'safety net' for millions of rural poor during lean periods when limited farm work is available. Specifically, by ensuring the poor a basic level of subsistence, MGNREGA (and similar programmes) does not only save lives but has also empowered and improved the lives of India's poorest and most vulnerable.

Similarly, B–P and D–S have divergent views on India's Food Security Bill passed into law in September 2013. The Bill provides about 75 per cent of the rural population and some 50 per cent of the urban population the legal right to stipulated quantities of staple food grains (5 kg of food grain per person per month) at subsidised prices, including free meals and maternity benefits for pregnant women and children between the ages of six months to 14 years. For D–S, the Food Security Bill will go a long way to combat the country's chronic malnutrition and hunger problem. However, for B–P, the subsidy will not only add to the country's already high and increasingly unsustainable fiscal deficit, but like other well-intentioned entitlement programmes, it will not produce the desired welfare outcomes. Specifically, they point out that India can hardly afford another massive entitlement programme, as the sad tragedy is that the food and related goods will hardly reach the intended beneficiaries given that it is to be distributed through India's notoriously corrupt and inefficient government-run nationwide network of over 500,000 'fair price shops'.[5] It is widely known that anywhere between a third to one-half of subsidised rice and wheat is illegally diverted from the fair price shops and sold in the open market. B–P aptly caution that the huge and costly public programmes like MGNREGA and Food Security, once established, are extremely hard to dismantle and replaced by more efficient programmes because of the rent-seeking opportunities they provide to a wide network of vested interests—including influential politicians. Sarcastically noting that good intentions do not always translate into good outcomes, B–P point out that the escalating costs of these programmes means that there are less available resources for the government to invest in health care, education, sanitation or in the country's decrepit infrastructure. Over time, such 'well-intentioned' programmes are self-defeating as they contribute to declining economic growth and stagnation. Not surprisingly, given their deep distrust and scepticism regarding the government's ability and intentions, B–P propose that it would be far more cost effective and efficient to give the intended beneficiaries of these programmes (who can now be easily identified via their electronic smart cards) cash payments or vouchers—conditioned for use on health, nutritional and educational services. In their judgement, allowing the poor to make decisions about their own welfare would constitute genuine empowerment of the poor.

Conclusion

Both B–P and D–S recognise that although economic growth is a necessary condition of poverty reduction, so is 'good governance'. As the authors well know, in India, much of the hard-earned growth has been lost or 'captured' because of ineffective governance. That is, even as the central and many state government's fiscal capacity has greatly expanded, their administrative and bureaucratic capacity has barely kept up. As a result, the perennial problems associated with widespread corruption, elite indifference and lack of transparency and accountability continue to hamper effective implementation and delivery of public policies and programmes. Yet, both sides remain optimistic that India's democracy will enable the country to correct the current governance challenges. For example, even as D–S note that "What remains true, 'partly because of the circumstances of Indian politics, is that underprivileged Indians are reluctant to rise and demand a rapid and definitive removal of their extraordinary deprivation' (p. 205), they also note that 'the democratic politics of India do offer opportunities for the most deprived Indians to reflect on their own strength, and to demand that the critically important inequalities that ruin the lives of so many people in the country be rapidly remedied' (p. 205). For D–S, the key is to make the political process more inclusive by bringing more people to participate in the decision-making process. In other words, they believe that India's democracy can be made more effective through reasoned public debate and collective action. However, the important question regarding how this can be done is not adequately addressed. Nevertheless, together the two books provide a comprehensive and nuanced state-of-the-art discussion of independent India's economic experience, including plausible strategies regarding its future economic trajectory. These accessible and authoritative books offer much food for thought and should be widely consulted by scholars, activists and public officials.

Notes

1. In India, there has been a long debate on what constitutes an appropriate 'poverty line'. According to the latest figures released by Government of India's national Planning Commission (in July 2013), some 22 per cent of the population were 'poor' in 2011–2012. This means that over 130 million people were lifted out of poverty since 2004. However, critics like D–S argue that the national poverty line has been set too low—even leading some to label the poverty line as a 'destitution line'. Indeed, if the poverty line factored in other variables than just the 'minimum calorie intake per person per day', the poverty levels would be much higher. As economics Nobel Laureate Angus Deaton has pointed out, poverty measurement is ultimately about 'democratic consensus, not scientific calibration'. For details, see Deaton (2013).
2. For example, India's labour laws remain highly restrictive. Specifically, under the Industrial Disputes Act of 1947, it is literally impossible for businesses with a workforce of more than a 100 people to lay off or fire workers. Predictably, as some 85 per cent of Indian firms are small scale and highly uncompetitive, far fewer labour-intensive manufacturing jobs have been created. For details, see Panagariya (2008).
3. The large-scale migration out of Kerala to the Gulf region over the past several decades explains the significant role remittances play in Kerala's economy. It is estimated 'that 2.4m Keralites were living and working overseas in 2014. The money they send home is equivalent to fully 36% of the state's domestic product. "For all practical purposes, it's a remittance economy."' see http://www.economist.com/news/finance-and-economics/21663264-how-torrent-money-workers-abroad-reshapes-economy-manna (accessed 11 April 2016).
4. To put it in wider perspective, MGNREGA's budget for 2012–2013 was US$ 5.28 billion or 0.28 per cent of the GDP. The central government covers 90 per cent of the programme costs. Although the Act provides all rural households with a right to 100 days per year of unskilled employment, state governments have authority to set MGNREGA wages equal to or above the minimum wage for unskilled workers.
5. The Food Security Bill is an extension of the targeted public distribution system (PDS), via which the Indian government (including many state governments) has been providing subsidised food. In fact, PDS is India's

largest food subsidy programme which provides households subsidised food (wheat, rice, cooking oils, sugar), including cooking fuel such as kerosene. The PDS also functions as a minimum support price mechanism for farmers.

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