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Friends of the Poor Are Often Their Greatest Enemies

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By Diana Furchtgott-Roth

Pope Francis has repeatedly called on those in positions of responsibility to protect and care for the poor. What is the best way to do this?

For an answer, look to a new book by Columbia University professors Jagdish Bhagwati and Arvind Panagariya, out next week from PublicAffairs. Based on data from India, it shows how countries can achieve higher growth and reduce poverty. Entitled *Why Growth Matters: How Economic Growth in India Reduced Poverty and the Lessons for Other Developing Countries*, it analyzes what India did right and what it did wrong in its struggle to lift its millions from poverty.

A concern for the poor is not the same as doing something effective about reducing poverty. The Indian experience shows that policies matter as much as objectives, and that the worst enemies of the poor can ironically be those who profess to be their friends. Pope Francis can use this important book as a guide to provide the pro-poor leadership that he promises from the Vatican.

An examination of global economic systems shows that capitalist systems have been the most successful in delivering high incomes and better quality of life. Look at economic growth in North Korea vs. South Korea, and, in the 20th century, East Germany vs. West Germany, the Soviet Union vs. Europe, Taiwan and Hong Kong vs. China.

The latest Economic Freedom of the World report, co-published by the Cato Institute, the Fraser Institute, and 70 other think tanks, finds that:

* Countries ranked in the top fourth of the world in economic freedom had average GDP per person of $37,691 in 2010, whereas countries ranked in the bottom fourth had average GDP of $5,188.

* For countries in the top fourth, average per person GDP of the poorest 10 percent was $11,382. In the bottom fourth, the same group earned $1,209.

* The average income of the poorest 10 percent of citizens of the most economically free countries was more than twice the average income for all citizens in the countries with the least economic freedom.

Or, as Catholic theologian Michael Novak wrote in *The Universal Hunger for Liberty*, "Developed countries are better able to order the economic elements of life to the good of human prosperity. In this way they reduce scarcities, raise the average age of mortality, eradicate diseases, diminish illiteracy, and so forth. To be well ordered for the achievement of such goals is what it means to be *developed*."

India's economic reforms started in earnest in 1991 after a balance of payments crisis, according to Bhagwati and Panagariya.

Prior to 1991, India's economy was characterized by extensive intervention, with strict industrial licensing for capacity creation and utilization, with Kafkaesque results. Bhagwati told me that the problem with India was that Adam Smith's Invisible Hand was nowhere to be seen.

India's public sector proliferated into every kind of activity, not just natural monopolies. When India produced inputs such as steel, the inefficiency undermined several user sectors in turn. These public sector enterprises were often given monopolistic positions, with no private entry allowed and with import controls preventing foreign competition.

Hence, India's share in world trade and trade to GNP ratio declined, while those in successful developing countries rose. Direct foreign investment shrank, and by 1991 equity investment into India had fallen to almost $100 million, smaller than the budgets of major American universities.

Bhagwati and Panagariya show that the 1991 reforms virtually swept away industrial licensing, reduced tariffs, and opened the way to entry by private firms into the industries reserved for the private sector, thus forcing them to compete. New firms such as Jet Airways entered private aviation in India, forcing Indian Airlines to raise its level of performance. The effect was a sharp rise in the growth rate and in the reduction of poverty.

Bhagwati and Panagariya explode a series of common myths about India's economic progress, such as that India pursued growth as an end in itself, without considering poverty reductions or the provision of health and education. They show that poverty fell more rapidly after the 1991 reforms than before.

Rather than more open trade leading to increased poverty, as is often alleged, the authors show that trade decreased poverty in India. They write, "trade openness in a labor-abundant economy stimulates growth in general and the expansion of labor-intensive industries in particular so that it can be expected to lower rather than raise poverty." In particular, two of India's poorer regions, Bihar and Orissa, now are among the fastest-growing states today.

India still has problems, of course, and the authors do not shy away from recommendations for changes in the provision of electricity, infrastructure, and transportation. Labor laws, many over 40 years old, need wholesale reform because they discourage hiring. Mandates on employers rise steadily with the number of employees.

For instance, manufacturers which use electricity and employ 10 workers, or those which do not use electricity and employ 20 employees, need to whitewash their premises every 14 months and repaint every 5 years. A firm with 150 employees must provide a lunch room, and a firm with 30 female employees must provide a day-care center. No one can be fired without extensive discussions with labor tribunals and courts.

Many anti-poverty programs focus on redistribution, but growth is a precondition to generate revenues to help the poor. This applies to countries with many poor and few rich, not only India, but also China, Indonesia, Brazil, and many countries in Africa. Redistribution cannot help countries where there is little to redistribute in the first place.

And welfare programs need careful consideration to be effective. One suggestion from Bhagwati and Panagariya: Replace the National Rural Employment Guarantee Act, which guarantees one member of a rural household 100 days' worth of employment at a given wage, with simple cash transfers through an ATM. These will give the poor more purchasing power and it will enable them to sell their labor at a higher wage.

All economic correlations are complex, and many factors are at play, but *Why Growth Matters* shows how the poor benefit from economic development, and which regulations can still stand in the way. As Pope Francis opens a discussion on reducing poverty, the book could not have come at a better time.

Diana Furchtgott-Roth is a contributing editor at RealClearMarkets, a senior fellow at the Manhattan Institute, and a columnist for the Examiner. She is the author of Regulating to Disaster: How Green Jobs Policies Are Damaging America's Economy (Encounter Books, 2012).