

## IX

### J.N. Bhagwati

Jagdish Bhagwati's work has so dominated thinking on trade theory and policy for the last three decades that Paul Samuelson has described it as 'The Age of Bhagwati' – in international trade. Precocious, public nuisance and contrary are some of the other epithets, less elevated than Samuelson's tribute, that Bhagwati and his work have attracted. Only someone precocious could have produced an innovative article on trade and growth whilst still an undergraduate at Cambridge. Policy makers in the US and elsewhere, the targets of his tenacious and many-pronged attack on protectionism, wouldn't dispute that he is a public nuisance. Neither his pen nor his tongue appears to run dry even after 40 books (authored and edited) and more than 250 articles on trade theory, trade policy, political economy and a variety of development issues including a vast number relating to India. Bhagwati was educated at the Universities of Bombay, Cambridge, MIT and Oxford. He is Arthur Lehman Professor of Economics and Professor of Political Science at Columbia University.

**Balasubramanyam** *You did your first degree in commerce at Sydenham College. You then went to Cambridge to read economics. What attracted you to economics?*

**Bhagwati** I was not interested in making money. I did not see commerce as a career. I was interested in scholarship and economics seemed like a very natural progression from commerce. I got really interested in economics at Cambridge.

**Balasubramanyam** *At Cambridge, Kaldor, Joan Robinson and others were your teachers. Who influenced you most?*

**Bhagwati** Yes, I had the good luck to be there when Joan Robinson and Nicky Kaldor were lecturing. They were the two major presences. Richard Kahn was also there, but I saw him only a few times. And then there was Harry Johnson lecturing on international trade. He was young, full of vitality and he was interested in students. He got me interested in international trade. I got interested in economics because of the fascinating group of people there. It became clear that economics could be used for social change, and coming from India, that was important to me. You suddenly saw the power of economics in thinking about policy issues.

In those days, English economics was not just about chess problems and fun and games. English economists reacted to real world problems and did what today you would call medium-level theory. Economics is an intellectual discipline, a social science, which can help you with policy issues. This was important to me coming from a poor country.

**Balasubramanyam** *You went to MIT from Cambridge.*

**Bhagwati** Yes, MIT was in many ways, I suppose it still is, the leading economics department in the world. My teachers suggested I go there for a year. Harry Johnson helped me apply to MIT. I got the Ford Foundation fellowship given to finance a developing-country student at MIT. Subsequently, Ronald Findlay (from Burma) and Carlos Diaz Alejandro (from Cuba) also got the same MIT fellowship. So there is a good track record for that fellowship, I would say.

**Balasubramanyam** *From MIT you went to Nuffield College at Oxford.*

**Bhagwati** Yes, because after about 9 months, I had learned as much as I wanted to learn at MIT. I enjoyed England, I am an anglophile, and I wanted to get back. Nuffield had just started; it was still being built. They had studentships. I applied and got one. When I arrived, half the college was not yet built. But all kinds of college policies were being established, because it was going to be a co-educational college, one of the very early ones. I was involved in very 'radical' issues, as Chairman of the Junior Common Room, on policies such as whether women and men should be on the same staircase and whether people could bring their wives into lunch and other such issues.

I can tell you a funny story about it all. Padma (Desai), who was not my wife then, was coming back from Harvard and I wanted to put her up for the night in college on her way to India. So I went to the Chairman of the Senior Common Room, David Butler, who was very bachelorish in those days and now he is married to Marion Butler (Professor of English at Cambridge) and is very much a 'family man' now. I said 'I want to put up a female friend in the college overnight; I hope that is OK'. He hummed and hawed and was obviously deeply embarrassed and said 'Oh, you can do that, provided you treat her the way you would treat a male guest'. So I said mischievously : 'what do you take me

for, a homosexual? Today, my image, at least in India, is mistakenly that of a conservative simply because I believe in markets and free trade. But, at Nuffield, I was already fighting for gender equality and later pursued this question in my research as well on returning to India.

**Balasubramanyam** *Then you went back to India from Nuffield.*

**Bhagwati** Yes, after about two years. Professor Mahalanobis was passing through Oxford. One of his great strengths was that he could spot talent. He also had no hang-ups about picking up talented people from anywhere and promoting them. That is how he built up the Indian Statistical Institute (ISI) at Calcutta to world-class status. He had set up a cell of the ISI in the Planning Commission at Delhi. Professors working there were loaned to the Perspective Planning Division of the Planning Commission, which was then headed by Pitambar Pant, a long time associate of the 'Professor', as he was fondly called.

Mahalanobis asked me to come back. So I resigned my fellowship at Nuffield and went to the Indian Statistical Institute at Delhi with the rank of a Professor. I was the only economist there. Ashok Rudra was there too, but he really was a statistician, and extremely clever. So I was one of 'the Professor's boys'.

**Balasubramanyam** *What did you work on at the ISI?*

**Bhagwati** My main work there from the beginning was on income distribution and poverty, a fact that would surprise many in India. Pitambar Pant had the idea that the country should aim at providing minimum levels of living for the poor, the bottom three deciles of the population. Then T.N. Srinivasan and B.S. Minhas joined us: both were on

the way to being world-class economists. We became a terrific group of economists, assisting and advising Pitambar Pant. Many distinguished economists also passed through, Ian Little, Alan Manne and Sir Donald MacDougall among them. But basically, we three were the 'think tank'.

**Balasubramanyam** *From the ISI, you moved to Delhi School of Economics as Professor of International Trade.*

**Bhagwati** Yes, in 1963, I moved to Delhi School as Professor of International Trade. Professor Ganguly had become Vice-Chancellor and there was what was called a 'leave vacancy'. I still remember the bureaucracy of those days. I received a 'warm' letter from the Registrar saying 'You have been appointed Professor of International Trade to fill the leave vacancy caused by Professor Ganguly's departure. You will not get any provident fund or fringe benefits, and you will be subject to dismissal without notice'!

**Balasubramanyam** *When did you go to MIT?*

**Bhagwati** In 1968. In 1966-1967, I visited Columbia for a year, at which point both Columbia and MIT offered me a tenured Professorship. I accepted the MIT offer, but then I decided to go back to Delhi School for a year since it would have been unfair to disappear without giving them time to adjust.

**Balasubramanyam** *Your first major paper was on Immiserising Growth.*

**Bhagwati** Yes, it is one of my best-known papers. I thought of the idea and started working on it in my first year itself at Cambridge as an undergraduate. Harry Johnson

encouraged me; in fact, he became my de facto supervisor. He was a very warm person, enormously helpful to students and much loved by them. He became my role model. I help my students and I am overwhelmed by the effusion of warmth of my students for me. I have been given three festschrifts, one organised by you at Lancaster.

Johnson helped me publish the Immizerising Growth paper. I had sent it to the Quarterly Journal of Economics, but it was rejected. Then Harry Johnson suggested I send it to the Review of Economic Studies. It came out in June 1958, became one of the famous papers in economics, and launched me in my career.

*Balasubramanyam* When did you begin work on the 1968 'Survey of International Trade' paper in The Economic Journal ?

**Bhagwati** I wrote this paper when I went back from MIT to Oxford. Roy Harrod was in charge of a major conference to be held in Brissago. Paul Samuelson was supposed to write the lead paper. But a month before the conference, one of his triplets fell sick and he opted out. There was no paper from him either. Apparently he had planned to write the paper at the last moment, the way he was reputed to prepare his lectures. We used to say at MIT that the quality of his lectures depended on whether he got into the elevator on the ground floor right away or it took him five minutes: If the latter, the lecture was better! So Harrod came to me and said, we have a problem, could you write the paper in about three weeks? It was such a big opportunity, because unlike today, there were few conferences in those days. I could not turn Harrod down, even though I was petrified at the short time available and the daunting nature of the task.

It was as if Laurence Olivier had dropped out and I, an understudy, was suddenly playing Hamlet, the Prince. It was a big break. All the top international economists including Haberler, Harrod, Johnson, Ohlin and Kindleberger were all at the conference.

**Balasubramanyam** *That is when you were called an agnostic on free trade.*

**Bhagwati** Right, I was accused of agnosticism on policy. I was reporting on what Haberler had said in his 1950 paper in The Economic Journal, to the effect that if you had distortions or market failure in the economy, you could not rank-order free trade and autarchy. Haberler was really undermining the case for free trade, which is a bit surprising because he himself was a free trader. I was not yet into policy, I was a theorist then. I was jumped upon by people who were into policy and told that what I was saying was nihilistic.

**Balasubramanyam** *This discussion later resulted in the famous 1963 paper with V.K. Ramaswami on domestic distortions and trade in the Journal of Political Economy.*

**Bhagwati** Yes, perhaps my most important paper on commercial policy and trade theory. There we put out the view that if you could fix domestic market failures with appropriate domestic policy instruments, you could restore free trade. Another way of looking at it is to say that you must have two policy instruments, one for trade – the free trade instrument – and another for fixing domestic distortions or market failure. This was a big breakthrough. This paper is a classic in the literature on the theory of trade policy; it gets you away from nihilism about free trade.

**Balasubramanyam** *So, in a sense, free trade becomes the rule rather than the exception. It was the other way round before your paper was published.*

**Bhagwati** Exactly, it is just that. You see, the most important papers in economics are not complex. They turn on how you look at a problem. It is not the complexity of your paper that matters, it is the way you transform the way a problem has been conventionally viewed. This is why the distortion paper is important: it overturned almost two hundred year of theorising about free trade.

***Balasubramanyam** Isn't it ironic that you wrote this paper, putting free trade back on the agenda in New Delhi, where import-substitution was the accepted policy? And you wrote it with the late V.K. Ramaswami, who as Secretary to the Commerce Ministry, was implementing the policy.*

**Bhagwati** Of course, I can't speak for why Ramaswami came to it. In those days, I was thinking about the problem as a trained trade theorist. I was also thinking about policy, being close to policy-making at ISI where I worked mainly on income distribution. I had developed a close friendship with Ramaswami and I used to ask him questions on policy: How do you take these decisions? In particular, as the economist operating industrial licensing, how do you choose between diesel engines and tractors or between the production of Fiat cars and other types of cars for awarding or rejecting industrial licenses and associated protection?.

Ramaswami confessed to me that he took the decisions but had no meaningful criteria for these decisions; there was really no theory you could bring to bear on these policy choices. In the Planning Commission also, I used to ask how various targets were set. When you looked at the targets carefully, you found no consistency, no optimality and no economic principles that make any sense. Besides, once set, these targets were actually turning into constrictive devices.



I began to think seriously about these issues. I had no leftwing constituency to worry about, unlike our Calcutta colleagues. Temperamentally, I also do not let others decide for me what I think and do.

In 1965, Minister C. Subramaniam and Dr I.G. Patel asked me to study the question of devaluation, as it was clear that the rupee was overvalued. I wrote a lengthy report on the subject for the Ministry of Finance. That is when I developed the concept of export bias (resulting from overvaluation), developing it further in my Frank Graham lecture<sup>xxxii</sup> in 1968. Then Professor Balassa also came out with the concept, independently of my work I believe.

**Balasubramanyam** *But you were fighting against a whole lot of people who didn't believe in exports.*

**Bhagwati** Absolutely. I said you could do away with both export subsidies (which had grown hugely) and import restrictions and unify the exchange rate. They all jumped on me, including the late Professor A.K. Dasgupta. That is how the controversy started. Nearly all of the old order economists were against devaluation. Ultimately I won out. At one stage, C. Subramaniam enlisted me to sell the idea of devaluation to Mrs Indira Gandhi who was then the Prime Minister, taking me to see her.

**Balasubramanyam** *But in the beginning, say until the early sixties, you too supported the import-substitution strategy.*

**Bhagwati** Yes, when I first came back from Oxford, we all were supporters of the policy. For a couple of years, we were all export pessimists. Like everyone else, I was a prisoner of my training. But I got off the bus very quickly once I saw the inefficiencies of

import-substitution. I don't know anyone whom we respected who was against import-substitution in those days. B.R. Shenoy was a vocal opponent but we (wrongly) put him down as a libertarian and an ideologue.

**Balasubramanyam** *The protectionists though can always fall back on non-economic objectives to defend their case.*

**Bhagwati** It is interesting that you say that. Reminds me of Kindleberger's recent review of my latest book of essays 'A Stream of Windows<sup>xxxiii</sup>'. He says very nice things about the book, but also misinterprets me and says 'unfortunately we have lost our MIT boy to Chicago'. He thinks I do not pay enough attention to factors such as culture.

In my book on 'Protectionism<sup>xxxiv</sup>', I explicitly address the issue of culture. The question is not whether you should encourage cultural objectives such as promoting locally made films, but how you do it. If you do it by protecting domestic moviemakers with import controls on Hollywood films, it doesn't really help them. What you should do is encourage local production through subsidies – by setting up a Film Institute for example, which supports the making of local films, and then let them compete against foreign producers. What I am saying is - what we teach to our students is what is called the theory of 'non-economic objectives' and optional policy intervention. The case for free trade is thus far more sophisticated than its critics think.

**Balasubramanyam** *You wrote often and kindly about Raul Prebisch, who is sometimes considered to be one of the architects of import-substitution policies that you criticise. Why?*

**Bhagwati** Raul Prebisch was a man of great distinction and there were many attractive sides to his personality. Unfortunately, he went wrong in advocating import-substitution. I do honour the man, but one has to say he went down the wrong road. Young Latin Americans today are prepared to say it. That enables them to embrace boldly new policies. But in India, we are not prepared to do this: we build up cult figures instead. We should honour people for their scholarship and achievements, but not embrace their policy advice when it is patently wrong. For instance, when Rajiv Gandhi wanted to introduce reforms, he talked to a lot of people like myself who were keen on reforms, but then re-appointed Professor Sukhamoy Chakravarty as Chairman of his Council of Advisers. Sukhamoy was a great scholar, but his policy preferences belonged to an era that the young Prime Minister was keen to put behind him. If you do this kind of thing, the Civil Service gets mixed messages. So what you don't get in India is clarity of purpose.

**Balasubramanyam** *Did the East Asian experience reinforce your conversion to free trade?*

**Bhagwati** No, the East Asian experience came much later. Mine was an intellectual conversion based on an examination of both the theory and the policy of protectionism.

It was back in 1962 that I began to change my views. Before that, I remember being sent to Japan as a member of a Committee of Wise Men, consisting of P.C. Mahalanobis, C.D. Deshmukh and Bharat Ram. I was talking to Saburo Okita, the Japanese economist, and telling him - you don't understand that external markets are tight, you can't promote exports and therefore import-substitution was desirable for Japan too. Elasticity pessimism was all over the place at that time and I shared belief in it. But all that vanished by 1964/65.

**Balasubramanyam** *It can be argued that at that time Japan was not doing all that well in external markets and other East Asian countries captured external markets. India didn't have such an opportunity.*

**Bhagwati** You are wrong, I am afraid. What you observe is a standard ladder of comparative advantage. When one rung is vacated by a country and it moves up, another country occupies the vacated rung. Continuous upgrading goes on as technology becomes sophisticated. There is a chart in Chapter 1 of my book, A Stream of Windows, prepared by Ross Garnaut, the Australian economist. There he shows that Japan's net exports of labour-intensive goods as a proportion of world trade in these goods went down steadily from 1970 to 1980, making room for the East Asian countries. Then in the 1980s, their share went down and guess who is coming up – China. So these changes are not additive, there is a progression. As you accumulate, you move out of labour-intensive production, the Rybczynski theorem applies. As you accumulate you move out of labour-intensive production, and others move in.

So, the only thing that we learned from East Asia is that we had been foolish in thinking there were no export markets. That is also a self-fulfilling prophecy. If you believe there are no export markets, you will not invest for exports, only for the home market.

**Balasubramanyam** *Your book with Padma Desai on India<sup>xxxv</sup> built on your theoretical work and attempted to measure the costs of protection.*

**Bhagwati** Yes, Padma should get credit for that work. She had a book on import-substitution and she had actually looked at how the Tariff Commission worked and how

it decided on tariff levels. Again, she found there was not much economic analysis in decisions about tariff levels. Tariffs were automatically granted on a cost-plus basis! This is what Max Corden later called 'made to measure' protection and we have called 'automatic' protection. The beauty of the book with Padma was that it built up a case against import-substitution from many directions. We didn't do econometrics, but we did a lot of institutional and analytical work to see how decisions were taken, what were the criteria for the decisions, and thus built up a strong case against India's inward-looking policies.

*Balasubramanyam* The system was very complex. But there were economic models on which the complex edifice was built.

**Bhagwati** Sukhamoy Chakravarty used to call them 'simple decision' models. Take the decision to have heavy industry. This followed from a 'simple decision' model that you can't produce and export more consumer goods and import more investment goods. Therefore, growth requires that you produce the investment goods (i.e. heavy industry) yourself. But this model led to bad policy because it was based on the erroneous assumption of export pessimism. The same mistake was made by the Raj-Sen model, a variant on the same theme, against which I wrote at the time.

Moreover, this led to other mistakes. Once you want to establish capital-intensive heavy industry, you have to do it in the public sector because the private sector won't invest in it the amount you want. This is where we got a heavy reinforcement of public sector enterprises. Given their inefficiency, which the Bhagwati-Desai book also highlighted, they cut into India's savings effort as well.

**Balasubramanyam** *So the establishment of public enterprises was a consequence of this need for accumulation, not so much social justice, income distribution and all that.*

**Bhagwati** No, the decision to establish public enterprises was always savings oriented in my opinion. I was influenced by Professor Mahalanobis who was saying that if we have public enterprises, you don't have to worry about taxing the private sector for savings, because you simply have access to the profits of the public enterprises.

It was because of all this that Padma Desai and I wrote extensively about public enterprises in our 1970 book on India. It is not that we were ideologically against public enterprises: far from it. Rather, we had already begun to see how our assumptions about the public sector had been, not just too optimistic, but downright wrong.

**Balasubramanyam** *Most American economists supported the overall Indian development strategy, I am told.*

**Bhagwati** Yes, everybody was rooting for India's success because India was pitted against China which was a totalitarian regime. These days, with the end of the Cold War, I don't think anyone abroad really cares whether we succeed or not. It is not hostility, it is just indifference.

**Balasubramanyam** *Looking at the other side of the picture, where do jobs come from if you adopt a free trade policy or an EP policy?*

**Bhagwati** Generally speaking, trade (in a static analysis) does not create jobs; it reshuffles jobs and creates 'better jobs' while giving up on 'worse jobs'. But, in the dynamic view, it can create jobs because export oriented countries have managed high

growth rates and growth generates jobs. In any case, where is the evidence that import-substitution generates growth and jobs?

**Balasubramanyam** *The controversy is fed by econometric work which attempts to relate exports or outward orientation to growth and finds the results inconclusive.*

**Bhagwati** There are so many things going on which regressions can't pick up. For example when we had the devaluation in 1966, there was also a huge harvest failure at the same time. And exports would have gone down anyway by a substantial amount, devaluation or no devaluation. T.N. Srinivasan and I concluded that, once the bad harvests effect were allowed for, the devaluation was a success.

It is incumbent on you to be more sophisticated. I am worried about the simpleminded cross-country regressions which are now multiplying. Jeffrey Sachs produces one set of regressions to prove trade is good. Then Lance Taylor or Danny Rodrik changes a variable, a proxy, or a lag or whatever and shows trade doesn't matter. So, to me this is 'mutual assured destruction' among regression-mongers. We really have to probe various mechanisms through which trade impacts on growth. This is what T.N. Srinivasan and I tried to do in our NBER book on India<sup>xxxvi</sup>. We have also written a paper recently, arguing against Rodrik's criticisms of the view that EP strategy improves growth rates.

**Balasubramanyam** *What about the size of countries? There are those who argue EP is a small country phenomenon.*

**Bhagwati** Why should size matter? EP is good for everyone, more or less.

**Balasubramanyam** *It could be argued that homogeneity of population makes it easier to promote outward looking policies. Large size promotes insularity.*

**Bhagwati** Yes, there is something to that. But a large country like the US has been fairly open, at least in the last 50 years.

**Balasubramanyam** *I guess there is considerable support for liberalisation in India from the middle income groups and the younger generation. But there is still some way to go.*

**Bhagwati** Yes, we have still a long way to go. We still have significant tariffs and quotas; quotas will however be reduced because we lost to the US the WTO case brought against our import restrictions under Article 18(b).

**Balasubramanyam** *Could we revert back to pre 1991 levels of protection?*

**Bhagwati** No, I do not think we will do that. Rather, the problem is with moving ahead. It is like a cart which is stuck in the mud, it will move neither backward nor forward. I don't think we will move back on trade or foreign investment. Even if there is a foreign exchange crisis, it nowadays leads to liberalisation rather than tightening of import controls. A crisis also compels you to encourage inflows of foreign investment.

**Balasubramanyam** *At present, we appear to have gone a long way in liberalising foreign investment, much further than trade. We still have tariffs on consumer goods. This would result in tariff-jumping foreign investment. I guess this was clear to our policy makers, but they had to retain tariffs on consumer goods for political reasons.*



**Bhagwati** I guess there are several reasons for this. Lobbying for tariffs by high-powered industrialists is one reason. In fact, lobbyists would have asked for high effective rates of protection – low tariffs on intermediates but high tariffs on final goods.

There was also some bad advice from economists. The Chelliah Report, otherwise excellent, set out different categories of goods on which tariffs should be reduced differentially instead of saying you should liberalise across the board.

***Balasubramanyam** What would you do with the loss making public enterprises? Several solutions have been suggested.*

**Bhagwati** I think one way to get at them is the indirect way the Chinese did it to begin with, though their current program is for privatisation. The Chinese method was to impose a hard budget constraint on the state-owned enterprises and let the private sector move in as rivals, thus a sort of crowding the state enterprises in a pincer movement. But this approach will work only if you are able to stick to the hard budget constraint.

***Balasubramanyam** And then there are the labour laws which compound the problem.*

**Bhagwati** Yes, that is a tough problem. The ILO is pushing for labour unions and for labour rights to be recognised as fundamental rights. I agree. But those rights have to be qualified. Along with the rights, we should have obligations. The record of irresponsible unions in Britain and in Peron's Argentina, and even our own in India, is not exactly heart-warming. We therefore need to have labour protection, but also labour obligations

with penalties for counterproductive behaviour that grossly and gratuitously compromises productivity.

**Balasubramanyam** *On a related matter, do you think that the movement to impose higher labour standards on us by Western nations such as the US, making them a precondition for WTO-guaranteed market access, is because of their fear of competition from us?*

**Bhagwati** Yes, that is certainly part of the reason. I have little doubt that labour unions are largely motivated by their worry about the competitiveness of our exports and would like to raise our production costs. You can see this from the fact that the AFL-CIO, the leading union organisation in the US, trained a lot of young students last summer through internships to agitate against sweatshops. But they all wound up screaming on campuses against multinationals paying low wages – which is certainly not the same as sweatshops – in Guatemala and elsewhere abroad, while ignoring the presence of real sweatshops (that violate safety and minimum-wage standards) in the US itself. That surely reflected the competitiveness concerns of the unions: they were concerned about US firms going abroad rather than sweatshops per se.

But there are also morally motivated groups which wish to extend labour rights everywhere regardless of competitiveness reasons. My response to them is: it is better to pursue these 'social' and 'moral' agendas in appropriate agencies such as the ILO and UNICEF. I have written extensively on this proposal. I have also recently organised a Statement by Third World Intellectuals and NGOs which develops this viewpoint and argues against 'Linkage' of such labour and other social agendas to WTO.

**Balasubramanyam** *At the same time, the left in the host countries complain that the multinationals pay too high a wage and create a labour aristocracy in these countries. This argument, of course, goes back to the 1960s.*

**Bhagwati** In the US, the young activists want multinationals to pay even higher wages. Workers in foreign firms are already paid a premium relative to those who work in locally owned firms. My stake-holder position is not that labour should be paid even higher wages for the lucky few, but that the multinationals should invest money in the community so that others profit also. That is the kind of humanitarian stake-holding I would like to see. Many firms do that here in the US, but they don't do it enough in developing countries. I would urge them to play the kind of role that they play here when they operate abroad in India, Bangladesh or wherever.

**Balasubramanyam** *Some of the developed countries are keen to make higher labour and environmental standards a precondition for WTO-guaranteed market access by our producers. Are our NGOs and governments looking at these threats?*

**Bhagwati** Few do, I am now in touch with NGOs in the Third World – India and Malaysia in particular. I am saying to them that they should mobilise. I am planning a Third World Intellectuals and NGOs statement on the subject.

You know, in September there is a WTO Ministerial at which the dimensions of the next round of trade negotiations will be discussed. The labour unions and NGOs here are taking 10,000 people to Seattle to agitate for the inclusion of a Social Clause in the WTO. We have to counter that with our own NGOs who speak to our viewpoints.

**Balasubramanyam** *May I ask you about education? In your Radhakrishnan lectures<sup>xxxvii</sup>, you talk about illiteracy and under-investment in primary education in India.*

**Bhagwati** I would emphasise that incentives matter here. People must have an economic incentive to send their children to school rather than to use them to work. There are cases where schools have been built and children haven't gone to school. Lots of people have documented these facts in evaluation reports. There is no news here as far as I am concerned. We have to ask why children don't go to school.

One thing, we can say, based upon the work of Becker on education, is that people do take economic factors into account when deciding whether or not to send their children to school. If you are at the margin of subsistence, the opportunity cost of sending children to school is very high. Losing a rupee of income could be fatal to your tight budget. Hence, if the returns to education improve, given the costs, the greater will be the incentive to send children to school.

But social beliefs can also matter here. Myron Weiner makes the point that in today's developed societies, social beliefs often provided the countervailing force to low pecuniary returns in education. Thus, in Prussia and Scotland, until the Protestant Reformation did away with them, the Catholic priests were the intermediaries to God: they prayed for you. With Protestantism, one got bible schools, so that children could learn to read the Bible instead of relying on the priests. His argument is that in the Indian case, unfortunately, social factors have worked against education. The caste system, instead of providing a countervailing force, actually reinforces lack of social and economic mobility and hence reduces further the incentive to send children to school.

So he is saying that there is no incentive in the system provided by religion and the social structure for learning. But then if you bring in a rapidly growing economy which provides paying jobs, people will invest in learning. In other words, what the social

factors can't do, economic factors can. That is why I think that, if we had experienced rapid growth, rather than the 3 to 3.5 percent we had for long, it would have made a big difference. Our policy failure is that we did not generate growth: poverty and illiteracy are both the result of these growth-reducing policy failures.

**Balasubramanyam** *Talking about labour flows, I would like to ask you if you have changed your position on brain drain. In your recent book A Stream of Windows, you seem to advocate freer mobility for skilled labour.*

**Bhagwati** On brain drain, I changed my views some time ago. Earlier, I was coming to it from the model which said that skilled manpower going out of developing countries would create problems at home. But now I have been influenced by my work on what I call the Diaspora model. It is that you really can gain in many ways by having your people here in the US, integrating them with the institutions here and establishing connections. There are a number of benefits which outweigh the losses. So, I now look upon emigration of skilled people from developing countries in a more benign fashion.

**Balasubramanyam** *Many skilled people are going back to India. Software engineers for example.*

**Bhagwati** That illustrates why I have changed my policy position. They are part of the Diaspora.

**Balasubramanyam** *Recently you have written on unskilled labour flows. Here too your views are benign.*

**Bhagwati** Yes, my views are also rather benign on unskilled immigrants into the US. I am in the middle of a book on the issue. The adverse effects of even illegal immigration have been grossly exaggerated here. The basic argument here is that unskilled illegal immigrants from Mexico are driving down the real wages of workers here. Now, if you are a liberal and worry about the poor here, you should worry about the poor in Mexico also. Moreover, output-mix changes seem to be absorbing the influx, without a serious decline in wages: this is the Rybczynski effect, of course. Finally, if you look at the data, there is an annual inflow only of 200,000, whereas the population of the US is 280 million and the labour force is around 190 million. Remember also that the supply of capital is also increasing and keeps the aggregate capital to labour ratio in balance, and so once again, there should not be much of an impact on real wages.

The fact that illegal immigrants are unskilled has led to a lot of anxiety as well. But this raises another issue which has to do with the welfare of the immigrant himself in this country of immigrants: we should not worry only about the welfare impact of his arrival on others. Here, the ethics of the choice of immigrants must point in favour of the unskilled. Thus imagine an island paradise somewhere which is owned by America. You are allowed to take in one more person. Which will you choose, a rich doctor from India or an unskilled peasant from Haiti?

**Balasubramanyam** *The unskilled peasant.*

**Bhagwati** Of course the Americans would say exactly that. This is what the Statue of Liberty is all about, the huddled masses and all that.

Then let us look at the impact of the arrival of the immigrant on us here. It raises the externality issue. You can't assume that the externality from the doctor is greater than that from the peasant. But when it comes to implementing policy, you don't know

how to measure externalities. As Professor Solow says wittily 'I know there are lots of industries with externalities, but my problem is that I don't know which ones they are'.

The conservatives here think there are externalities associated only with skilled immigrants. But I can argue that, when unskilled immigrants take up jobs as housemaids, for instance, that enables women to go to work and that this is a positive externality.

**Balasubramanyam** *The frequent argument though is that unskilled immigrants accept low wages and create unemployment for local labour.*

**Bhagwati** A lot of immigrants come into the inner cities and take up jobs. But they are demonstrating that, where locals complain that employment is hard to find, they actually find work to do. It is not that there is some 'iron ceiling' on employment and work. The immigrants are demonstrating that you can find work and that 'structural-cum-cultural' barriers to finding gainful work must be examined. This is a big positive externality.

**Balasubramanyam** *You are surely not advocating free immigration without controls; there would be problems if you remove all controls.*

**Bhagwati** I agree. Huge rates of immigrants can create social problems. We have to worry about the place at which immigration occurs. But that still leaves us more relaxed about immigration than most immigration opponents.

**Balasubramanyam** *Your views on immigration now complement your views on trade and direct foreign investment. However, you have recently advocated capital controls.*

**Bhagwati** Yes, but not quite. I am talking about monitoring a willingness to tax capital flows. If you face suddenly huge capital outflows, however, temporary controls make sense. Thus, I thought it was absurd that the IMF did not insist that Russia should restrict outflows when the IMF loan of \$5 billion was immediately taken out as Russia defended the ruble. As Padma Desai, now a leading Russian expert in the US, has argued, it was wrong to eschew capital controls when the Russian economy was in chaos, following the Asian crisis and the collapse of oil prices, and it could be reasonably forecast that the defense of the ruble, while capital outflows were permitted, would simply 'eat up' the IMF loan.

**Balasubramanyam** *Thank you for talking to me on such a wide range of issues including your recent views on brain drain.*