

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

By Jagdish Bhagwati and Arvind Panagariya

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In their new book, *Why Growth Matters: How Economic Growth in India Reduced Poverty and the Lessons for Other Developing Countries*, Professors Jagdish Bhagwati and Arvind Panagariya describe the role played by market liberalizing reforms in setting India on a path of higher growth and the continuing need for further reforms to lift India's remaining poor out of poverty. Both authors have a long and distinguished record of participating in and influencing public policy debates, and this, their most recent book, aims to have a similar impact. The authors succeed in providing a worthy contribution to our understanding of the impact of reforms. Those readers with an eye towards policy in general will profit from Bhagwati and Panagariya's account of Indian reforms since 1991, and those readers interested in the specific case of India should consider the authors' proposed agenda for further reforms. But, as I will argue, *Why Growth Matters* can be read profitably by all economists. Bhagwati and Panagariya provide a model for the role of an economist in society, one which more economists should adopt.

Bhagwati and Panagariya's thesis argues India, with its combination of democracy and growth, serves as a model other developing countries should adopt. The authors divide the reform agenda into Track I and Track II reforms. Track I reforms are those designed directly to benefit economic growth, such as trade liberalization and decreasing the regulatory burden imposed on firms. With economic growth comes increased government revenue, which because of democracy, can be directed towards Track II reforms, or those of a more redistributive nature designed to ease the plight of society's most impoverished members. The authors structure their discussion by organizing the book into three parts. The first part details the history of Indian

reforms and the impact they have had on increasing growth and reducing poverty, the second part discusses further Track I reforms the authors believe should be implemented, and, similarly, the third part of the book proposes further Track II reforms. Policy-oriented audiences will find all three parts useful, whereas the first part offers the most for economists of all interests.

The reason part one of the book can be read profitably by all economists is because it is an excellent example of how the economic way of thinking, along with careful data analysis, debunks myths surrounding cause and effect, in this case the impact of particular policies introduced after 1991 in India on growth, inequality, reduction in poverty, etc. Bhagwati and Panagariya speak to the critics of Indian reforms and the myths they peddle related to those reforms. The authors push back with logic and facts against critics, many of them ideologically driven, and, so, in the process, raise the level of discourse. In this way, they continue to play an important role in policy discussions surrounding India, and, if their future achievements match their past ones, the authors will have a real impact on the lives of people throughout India. Take just one example, Myth 6.4, so-called because it is the fourth myth debunked in Chapter 6 (Bhagwati and Panagariya respond to nineteen myths spread across five chapters). Myth 6.4 states, “The reforms were forced on India by Bretton Woods institutions captive to the “Washington Consensus.”” But, as Bhagwati and Panagariya argue, this is the Washington Conceit; reforms occurred endogenously after the 1991 crisis shifted Indian demand for reforms. It was Indian thinkers and policy-makers who proposed reforms and continued to push reforms through, instead of reversing reforms, as would have occurred in India’s democracy, had the reforms been resented for being imposed from abroad from the beginning.

The remaining parts of *Why Growth Matters* put forth an agenda for further reforms. The most important Track I reform on Bhagwati and Panagariya’s agenda seems to be eliminating

labor market frictions, which make it difficult for Indian firms to tap into the country's pool of low-skilled labor and result in a distribution of firm size skewed inefficiently towards small establishments. Indeed, one of the most striking features of Indian development since 1991 is that India is not China, i.e. Indian development is not a story of low-skilled labor creating internationally competitive firms, as is the case in China. Instead, Indian development has been driven by firms employing high-skilled labor and capital. This is a striking and depressing fact. Ricardo scratches his head. One gets the impression of a huge missed opportunity. India could be China. India's vast reserves of low-skilled labor are not allocated efficiently because of labor market frictions. Reforming labor markets could fuel a new wave of Indian growth and directly pull poorer members of society up the income and development ladder. This is the type of Track I reform which not only directly impacts growth but simultaneously achieves Track II's goal of helping the poorest members of society.

The main weakness in *Why Growth Matters* stems from insufficient attention paid to the difficulties surrounding a democratic reform process, which is important because Bhagwati and Panagariya argue India, with its combination of democracy and growth, is a model for other developing countries. The authors recognize the democratic process unfolds slowly but find intrinsic value in the inclusive nature of democracy. But, it has taken Indian democracy 50+ years to arrive where it is today. The reforms initiated in 1991 emerged as the response to a significant economic crisis. Is this really the model the authors envision for reform? How could the Indian reform process have been improved? What are the mistakes other developing countries should avoid? These political economy issues are not discussed, a real pity given the combined analytical credentials of the authors. Along these same lines, the book would have benefited from a discussion of lobbying and special interests involved in the reform process.

How likely are the authors' proposed Track I and Track II reforms given these special interests?

The authors did a superb job discussing the impact of reforms and laying out their agenda for further reforms, but more analysis on the political economy of reforms would have strengthened the book.

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