From The President's Desk

by Mark Skousen

Poverty and Wealth: India Versus Hong Kong

"The government of India regulates nearly everything, so there's very little progress; whereas in Hong Kong the government keeps its hands off . . . and the standard of living has multiplied."

—John Templeton[1]

The mutual fund magnate John Templeton traveled around the world during the 1930s, noting in particular the extreme poverty in two Asian nations under British control, India and Hong Kong. Forty years later, in the 1970s, Templeton returned. Once again he witnessed the incredible poverty in India. But Hong Kong had changed tremendously. "The standard of living in Hong Kong had multiplied more than tenfold in forty years, while the standard of living in Calcutta has improved hardly at all."[2]

Today neither country is under British rule, but the contrast is even more clear. Hong Kong enjoys the greatest concentration of wealth in the world. India suffers the greatest concentration of poverty in the world.[3]

Twenty years ago, development economist P.T. Bauer wrote a famous little essay in which he pondered, "How would you rate the economic prospects of an Asian country which has very little land (and only eroded hillsides at that), and which is indeed the most densely populated country in the world; whose population has grown rapidly, both through natural increase and large-scale immigration; which imports all of its oil and raw materials, and even most of its water; whose government is not engaged in development planning and operates no exchange controls or restrictions on capital exports and imports; and which is the only remaining Western colony of any significance?"[4]

Indeed, the prospects for Hong Kong were dismal. Yet by making cheap products for export to the faraway West, it managed to become the powerhouse of Southeast Asia. Today its citizens' incomes rival the Japanese, despite its teeming seven million people crowded into 400 square miles. What broke the vicious cycle of poverty? According to Bauer, Hong Kong's economic miracle did not depend on having money, natural resources, foreign aid, or even formal education, but rather on the "industry, enterprise, thrift and ability . . . of highly motivated people."[5] Hong Kong's "overpopulation" turned out to be an asset, not a liability.

Equally important, Britain did not interfere in private decision-making. It adopted a laissez-faire economic policy, except in the area of subsidized housing and education. Communist China has pursued a largely non-

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interventionist approach since it took over in 1997. Hong Kong continues to flourish with a stable currency, free port, and low taxes. Its maximum income tax rate is 18 percent, and it imposes no capital-gains tax. In its economic freedom index, the Fraser Institute has always ranked Hong Kong number one in the world.[6]

Tragic India

India is an entirely different story. Its population of one billion remains relatively poor. Unlike Hong Kong, India has valuable natural resources—forests, fish, oil, iron ore, coal, and agricultural products, among others. It has achieved self-sufficiency in food since independence in 1947, yet deep poverty persists.

Many pundits blame India's anti-capitalist culture, its fatalistic caste system, its overpopulation problem, and its hot and humid climate (it reached 117 degrees when we visited the Taj Mahal last June). But Milton Friedman identified the real culprit when he wrote, "The correct explanation is . . . not to be found in its religious or social attitudes, or in the quality of its people, but rather in the economic policy that India has adopted."[7]

Indeed, in the decade after independence, Nehru and other Indian leaders were heavily influenced by Harold Laski of the London School of Economics and his fellow Fabians, who advocated central planning along Soviet lines. India adopted five-year plans, nationalized heavy industries, and imposed import-substitution laws. Worse, they perpetuated the British civil-service tradition of exercising controls over foreign exchange and requiring licenses to start businesses.

Even today, India is a bureaucratic nightmare.[8] Parth Shah, an economist and head of the Centre for Civil Society (www.ccsindia.org),[9] describes how he recently returned to India and toiled to find an apartment in New Delhi (thanks to rent controls), then spent half a day standing in line to pay his first telephone bill and another half a day to pay his electricity bill. "Corruption has become the standard among those who are in public service at every level," reports Gita Mehta, a well-known Indian writer.[10] India has ranked around number 100 over the years on the Fraser Institute's index of economic freedom.

Yet there is hope. In 1991, facing default on its foreign debt, India abandoned four decades of economic isolation and planning, and freed the nation's entrepreneurs. It sold off many of its state companies, cut tariffs and taxes, and eliminated most price and exchange controls. As a result, India became one of the world's fastest-growing economies in the 1990s, averaging nearly 10 percent growth per year. Most important, while the rich have gotten richer, poverty rates fell sharply in India.

What can the new prime minister, A. B. Vajpayee, do now? Can India ever catch up to Hong Kong? India must cut its government deficits (currently 10 percent of GDP); cut tariffs and taxes further; privatize state enterprises; eliminate red tape; and restore honesty in government. It's a tall order but the only way to achieve what Adam Smith called "universal opulence which extends itself to the lowest ranks of the people."[11] □

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1. Quoted in William Proctor, *The Templeton Prizes* (New York: Doubleday, 1983), p. 72.
2. Ibid.
3. For an excellent updated survey of India, see "Unlocking India's Growth," *The Economist,* June 2, 2001.
4. P. T. Bauer, "The Lesson of Hong Kong," in *Equality, the Third World and Economic Delusion* (London: Weidenfeld and Nicolson, 1981), p. 185.
5. Ibid., p. 189.
6. James Gwartney and Robert Lawson, *Economic Freedom of the World, Annual Report 2001* (Vancouver, B.C.: Fraser Institute, 2001), p. 172.
7. Milton Friedman, *Friedman on India* (New Delhi: Centre for Civil Society, 2000), p. 10.
8. See John Stossel's amazing example in his ABC Special "Is America #1?" available on videotape from Laissez Faire Books, 800-326-0996.
9. The other free-market think tank, the Liberty Institute, is run very capably by Barun Mitra. Shah and Mitra hosted my visit to India in June 2001.
10. Gita Mehta, *Snakes and Ladders: A Modern View of India* (London: Minerva, 1997), p. 16.
11. Adam Smith, *The Wealth of Nations* (New York: Random House, 1965 [1776]), p. 11.

IDEAS ON LIBERTY
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It's Unpatriotic to Raise Prices After a Disaster?

It Just Ain't So!

One issue that caused a minor controversy after the terrorist attacks on September 11 was so-called price gouging. On his popular TV show, *The O'Reilly Factor,* Bill O'Reilly made a big deal of it with Jennifer Granholm, attorney general of Michigan, and Dan Mogin, a consumer lawyer from California.

O'Reilly accused the Sheraton Hotel at Kennedy International Airport, a Holiday Inn in New York City, and Alamo Rent A Car in Charleston, South Carolina, of taking advantage of the terrorist attacks by raising prices. Granholm mentioned that there were 13 gas stations in Michigan that overcharged consumers; she called them un-American. Mogin said it violated New York's consumer-protection laws for a business to charge an "unconscionably excessive price." Who determines what is "unconscionably excessive"? The legislators in New York state obviously believe they do.

Apparently, there were some gas stations that charged $5 a gallon soon after the attacks. The news media reported that many consumers were angry. Those gas stations would have loved to charge not $5 but $50! Why didn't they? Because prices are a function of supply and *demand.*

If prices are really too high, suppliers have no choice but to lower them. (In fact, gas prices fell dramatically soon after September 11.) However, if prices go up and stay there, enough consumers must be willing to pay the higher prices. Some will object to this argument, saying consumers have no choice. But people don't trade with each other unless each expects to benefit. Even though I would enjoy paying nothing to attend a San Jose Sharks game, my paying $100 for a seat proves that the benefit to me of spending the money outweighs the cost—anything else I could have done with that $100.

Why Pay More?

Remember that if a business wants to raise its prices higher than its competitors' prices, it might hurt itself. Why would a consumer pay a higher price if he had alternatives? In a free market consumers are sovereign. O'Reilly proudly said, "I would never go to these places!" That's the point: we choose where to spend our money.

When people become outraged at higher prices, they act as though they have a right to a hotel room, a rental car, or a tank of gasoline on their own terms. They fail to understand that prices reflect supply and demand and that sometimes these conditions change.

As Henry Hazlitt noticed, when people protest a new higher price, they imply that the old price was okay. He said in *Economics in One Lesson*, "That starting or previous price is regarded as 'reasonable,' and any price above that as 'unreasonable,' regardless of changes in the conditions of production or demand since that starting price was first established." Yet people protested when the price first went up to the original level. This logic regresses until the good or service is free!

After a tragedy, such as the destruction of the World Trade Center, demand for certain goods and services goes up and suppliers might also anticipate restricted production of certain goods. Thus higher prices are not only justified in the sense that they are called forth by new conditions, but they also help to ration goods and services, encouraging people to conserve and to satisfy only their more urgent needs until conditions loosen up again.