



chapter 1

Know Thyself

If you look at yourself and your friends, you will find that you have a special ability that separates you from all other living things. It is the ability to **trade**. In other words, the ability to barter and exchange things.

This is an innate ability. Even little children engage in gainful trade: Give me some of your chips and take a sip of my cola. This ability to trade is natural to all. No one has to be taught how to trade.

The ability to trade is far superior to the ability to use tools and manufacture things. Weaverbirds manufacture excellent nests but we do not see them operating construction sites for early birds in exchange for the worms the latter are so adept at collecting.

THE ABILITY TO TRADE MAKES US “ECONOMIC”.

Human beings therefore have an economy. No other creature has an economy, because no other creature has the ability to trade, although many can actually “manufacture” something or the other as, for example, weaverbirds.

We are therefore also called *Homo Economicus*. We are the planet’s only “economic” creatures. We are indeed unique.

We, each of us, are specially programmed to generate wealth. And trade creates wealth.

YOU ARE BORN TO BE RICH.

A weaver bird might dine



Off

caviar and wine

If he could trade

his nifty nest

For gourmet food

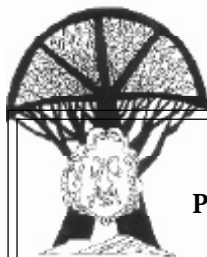
—the very best.

ALAS!

the little worm is his fate

For lack of just

this little trait.



POINTS TO PONDER

- At what age does a human infant display the ability to trade?
- Can monkeys, our closest cousins, trade?



chapter 2

Population Causes Prosperity

Having said that *Homo Economicus* is a machine programmed to generate wealth, it becomes necessary to examine the argument taught in Indian Economics that India's huge human population is a cause of poverty. If humans are the only species capable of creating wealth, then how can more of their number cause poverty? What is the truth?

The truth is that every dot on the map, representing a town or a city, is densely populated with human beings—and is rich. There are more millionaires, cellphones, Mitsubishi Lancers, and swimming pools in crowded Delhi than in vacant Jhoomritalaiya. Why is this so? For the answer, we must turn to Economics, which is *the study of the production of wealth*.

Because we can trade, we SPECIALISE in doing what we do best and exchange with others for the things that they do best. Unlike animals, human beings are *not self-sufficient*. Instead, they tend to find specialised niches in which to work. From these niches they produce goods and services which they exchange in the market economy. Thus you have farmers, fishermen, goatherds, journalists, dentists, washermen and so on. No other species specialises in this manner because they do not have a market economy, which is the result of our special ability to trade. *This is how wealth is created.*

Human beings, being “economic”, should never be advised to be “self-sufficient”. Imagine your plight if you decided to opt out of the exchange of goods and services and had to do everything yourself. Imagine what would happen if your family became “self-sufficient”; and then your village, or your town. This would mean that not only would you be compelled to grow your own food and wash your own clothes, it would also mean that you would have to learn to build your own house and learn surgery. At no level does self-sufficiency improve the lives of those who practice it. All it does is to divert your productive energies from those areas which you are most competent to those where you are relatively unskilled. If it is bad for a person, a family, a village or a town to practice self-sufficiency, surely a great nation like India cannot gain by pursuing such a path. *Self-sufficiency is economic suicide.*

A little experiment can be attempted: Go to a kindergarten class and ask the little children what they want to be when they grow up. They will answer: actor, dancer, policeman, and so on. I’ll bet that not a single little child will say: I want to grow up and be self-sufficient. If it goes against the logic of little children, how could it be logical for the entire nation to practice self-sufficiency?

When we specialise in the market economy, a phenomenon occurs which economists call the *Division of Labour*.

ECONOMICS IS THE STUDY OF THE PRODUCTION OF WEALTH THROUGH THE DIVISION OF LABOUR.²

² It will later be argued that the division of labour is accompanied by the division of knowledge.

The division of labour into innumerable specialised roles is best possible in an urban area—denoted by a dot on the map. It is extremely difficult in a rural area where there are very few people, and thus, very little scope for being, for example, a successful dentist or even a *dhobi*.³

Therefore, every dot on the map (representing a town or city) is densely populated and quite rich. Wherever human beings are densely crowded, as in a city or a town, there is greater prosperity than in any vacant countryside simply because there is greater division of labour. The extent/degree of the division of labour depends on the size of the market. For example, if you wanted to open a Thai restaurant and you needed 100 diners a day to break even; and if one out of every 100 people wanted Thai food on any given day, you would have to set up shop in a town where there are at least 10,000 potential customers. This is why crowded cities are rich: there is greater division of labour. This is a universal phenomenon: Not just Delhi and Bombay, but London, Tokyo, New York, and Paris are densely populated and rich.

The world is 50 per cent urbanised today: half the world's population lives in towns and cities. India is far below the world average at about 30 per cent, but the richest states of India—Gujarat and Maharashtra—report urbanisation levels close to the world's average of 50 per cent. The poorest states of India, like Assam and Bihar, report urbanisation levels below 10 per cent.

Urban areas are rich because population causes prosperity.

It is important to note that the word “civilisation” has its root in the Latin word *civitas*, which means “city”. The story of civilisation is the story of great cities coming up around the Mediterranean and linking up supplying goods and services to each other: the small, safe sea providing the transportational backdrop around which trade could take place. Mohenjodaro and Harappa were great cities, linked to the Mediterranean through the port of Lothal. *Cities and towns are the anthills of human colonists.* It is futile to pursue “development” while cities face ruin.

Across the world, urbanisation causes prosperity by aiding division of labour. Countries like India would therefore be better off pursuing

³ Or washerman. The various sub-castes that exist prove that India was and is an urban civilisation. A rural world of self-sufficient villages would not have produced sub-castes marked by specialisation and the division of labour.

urbanisation as a means to prosperity instead of doing what our government has been doing all these 50 years—spending money uselessly on “rural development.” A recent Arthur Andersen-*Fortune* survey of cities world-wide found Indian cities to be the worst in the world! This is not the way to become a prosperous country.

Apart from general misgovernance, one of the prime reasons for the ruination of our urban areas is the undersupply of roads. We shall later discuss this issue in greater detail. For now, let it be understood that there are over 400 names in the STD code-book but most of urban India (62.5 per cent of India’s total urban population by some estimates) is focussed in a handful of huge metros, which are growing every day. Urban geographers, those who study the geography of towns and cities, call this phenomenon *primacy*. Primacy occurs when the primary city bloats up because it is not properly linked to the surrounding towns. If there had been proper roads, satellite towns would have blossomed, and each of the 400 names in the STD code-book would have become a little Singapore.

The British built many fine cities and countless “hill-stations” in their time. In the last 50 years our urban areas have all been ruined. In British India, the hill-stations were all linked to a metro: the Darjeeling–Shillong belt to Calcutta; the Poona–Mahabaleshwar belt to Bombay; the Ooty–Coonoor belt to Madras; and the Simla–Mussoorie belt to Delhi. With such strong links to urban metropolises, all our urban centres can become like Singapore. Remember Singapore received independence only in 1965. From a dirty little town crowded with coolies and hawkers, it has become a thriving city today.

Because of the undersupply of roads there is urban overcrowding in India, but that does not mean the country is “overpopulated.” Travel by train or plane around India and you will see vast open spaces. India’s population density (number of people per square kilometre) is LESS than that of Japan, Germany, Holland, and Belgium. And these countries do not report urban overcrowding. The solution to urban overcrowding lies not in birth control, but in roads that will allow many more towns to come up and link up with the main city. With more urban areas—400 Singapores—Indians will have sufficient living space and overcrowding would end.

This argument therefore generates *A Conflict of Visions*. Instead of seeing the future of India in terms of thousands of self-governing and self-sufficient village republics (the Gandhi–Nehru vision), we can see India as

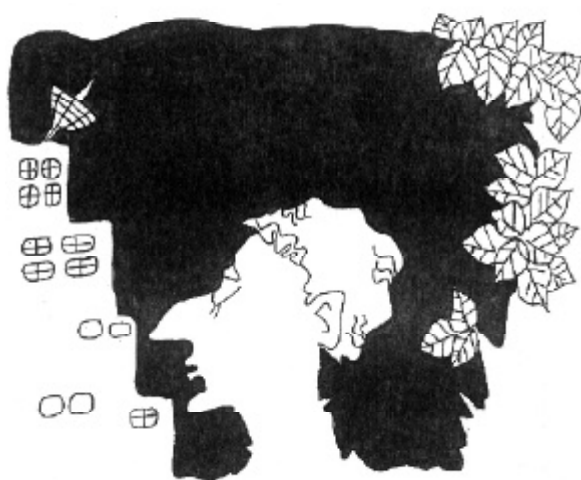
an urban civilisation. With 400 excellent cities, all well linked to each other by rail, road and air, a maximum of trade can take place at the least cost. A poor transportation network makes trade slow and expensive. A truck travels 250 km a day on Indian highways; they do more than 600 km a day in the rest of the world!

It is said that “every great city sits like a giant spider on its transportation network.” India needs such cities and towns.

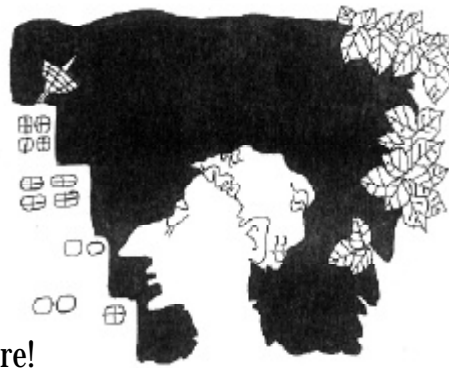
SINCE HUMANS ALONE ARE ECONOMIC, AND SINCE CITIES ARE RICH, IT MUST BE SAID THAT THE ARGUMENT THAT POPULATION CAUSES POVERTY IS THE DEVIL’S PHILOSOPHY.

It makes mothers and fathers ashamed of producing children. It makes children feel that they are not a resource, rather, they are a problem. It makes cynics look at traffic accident statistics and say that our unsafe roads are a means of solving “the population problem.”

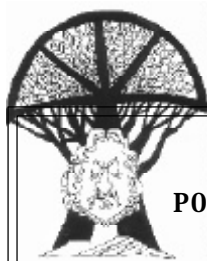
Human beings are the world’s ultimate resource—because they all possess the human mind. You are trying to pour knowledge into that mind. Please make sure that what you feed your mind is the truth. A false philosophy will deaden your mind. It will not make you see that, with your mind and the ability to trade, you can generate wealth by doing what you do best in a free market economy. Instead, it will train you to look upon yourself and your brethren as a huge problem that requires political action to solve. To understand why political interference in the market economy is very harmful to us and our country, let us now turn our attention to the *political market*.



I'm off to Bombay
To make my fortune
There are jobs
a-plenty there—
I'll be a watchman,
waiter, cop
Even a film star—
if I dare!



I'm off to Bombay
Where millions live
And a million dreams come true.
My village is poor with nothing to give
So what else is there to do?



POINTS TO PONDER

- Look around your town and try and find unusual instances of the division of labour. Think whether that particular activity could be carried out profitably in a sparsely populated village. For example: An Institute for Ear Diseases.
- Try and find some poor people who make a living in the city by participating in the division of labour (for example: a dhobi). Think whether that man would be better off in a village. Ask him too.



chapter 3

Why Political Markets Don't Work

Suppose you went to your town's main market. You would find plenty of shops selling all kinds of things, and many vendors of food. But you would have only a limited amount of money in your pocket. You cannot buy everything on offer. Because resources are limited and wants are not, you would have to make choices. You would have to decide whether you would prefer to spend on a chocolate bar and forego a cone of icecream or the other way around.

The central problem of Economics is Choice.

There are limited resources and unlimited wants, and so we must make choices as to how to spend these resources. There are two kinds of

choices we make: private choice and public choice.

Private choices are made in the private market and the main players in this market are consumers and producers. This is how we buy our food, clothes, toys, music, books, and anything else we desire.

Public choices refer to those made in the POLITICAL MARKET and the main players in this market are POLITICIANS, BUREAUCRATS, SPECIAL INTEREST GROUPS, and VOTERS. This is how we get our roads, our garbage clearance, our police, and our national defense. Remember, even in the political market, resources are limited. If we spend more on defense we have less for education. PUBLIC CHOICE THEORY is that branch of Economics that looks into how choices are made in the political market (in a liberal, democratic setting).

In the private market, consumers spend their money and choose between various options. Because they are directly affected by each choice they make—and they suffer if they make wrong choices—they take great care to *seek out information* and to *correct past mistakes*. If you purchase a cassette player of X brand, and it turns out defective, you will not buy that brand again. Thus, in the private market, money is usually well spent. If most spending decisions were to take place through the private market, most of society's money would be well spent.

In the Political Market, there are certain reasons why money is not well spent, even in the best of democracies, with the best personnel serving the State:

- Politicians are primarily interested in *re-election*. They will spend a lot of public money in ways that ensure them votes. The two-rupee per kg rice scheme in Andhra Pradesh is a good example. As is free water and free power to farmers.
- Bureaucrats are primarily interested in *budgets*. They will always attempt to ensure that their departments get more money from the tax kitty. The Budget Deficit—which shows how much the government spends ABOVE what it takes in tax revenue—is not going down because bureaucratic departments at all levels want to go on spending more money.
- Special interest groups and voters are both interested in *free lunches*. Some gain for themselves at a cost to others. They will look for ways that public money is spent on them—they get something free—while the costs are borne by other taxpayers who are not politically organised. A good example is the high import duties that protect India's industrialists.

They are few, vocal and organised; the consumers are many, but unorganised, and they pay the duties.

It is also important to note that political spending is not directed towards the majority. It is directed towards small and vocal minorities who are all well organised politically. The politician directs spending in favour of these minorities, and the majority pays. A good example is agricultural subsidies in the US, which go to 2 per cent of the population who are farmers, but the costs are borne by 98 per cent of the people, who are not as organised as the farmers. Another example is the high import duties on steel imposed in the US: it benefits a few uncompetitive American steel producers, but millions of American steel consumers pay.

It is best to examine the difference between the way money is spent in political and private markets thus:

Friedman's Law of Spending*

There are four ways of spending money:

- You can spend your own money on yourself
- You can spend your own money on others—buy gifts
- You can spend other people's money on yourself—buy things on the “company account”
- You can spend other people's money on some other people: *political spending (or central economic planning).*

It follows that maximum reliance on people spending their own money is good for society, in that most of society's money is well spent. On the other hand, maximum reliance on the state as a means of spending money—economic planning—is bad, because most of the money is not well spent.

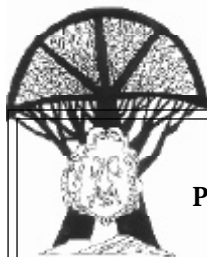
Economic planning is some people spending other people's money on other people. This is a sure way of spending money badly.

Private spending is better than political spending because of the 3I's: Interest, Incentive and Information. Consumers have the interest, incentive and information to spend money wisely. The political market players do not. Indeed, they have an incentive to spend money unwisely!

* Milton Friedman, Nobel laureate in Economics is the greatest advocate of free markets. Read his book *Free to Choose*.

Economic planning is some people spending other people's money on other people. This is a sure way of spending money badly.

Free power
Free water
Guess who pays for it.
Free lunches
Free schools
Make politicians a hit.
Free-handed
Free-hearted
With money they don't earn.
Free people
Free India
From those who will not learn.



POINTS TO PONDER

- What are the incentives for a voter to seek out all relevant information before casting his vote?
- Are these incentives adequate? That is: Does it make sense for every voter to thoroughly check out each candidate, each manifesto and so on? Do most voters do this?
- If not, how much reliance should be placed on government, even if democratically elected?



chapter 4

Public Goods and Market Failure

In classical economic theory that stressed the role of the free market and entrepreneurship, there was a recognition of the fact that there are some things that businessmen will not be able to supply, and so it was deemed necessary to provide these from the collective kitty: the tax revenues of the state. Those things that the private market will not step in to supply were called *public goods*.

A public good is one that cannot be bought and sold because its services are available free to all those who want to use it. Examples are a road or police service. Everyone will build a house for himself, but no one will individually build a road in front linking all the houses—unless he can

charge every road user. This is usually unfeasible.

Lighthouses were listed as public goods which the state must supply because a private businessman will not build one since he cannot charge ships which see the light. The same can be said of streetlights in our cities.

It makes sense to spend tax money on public goods because then we could increase the sum total of our consumption. We all live in homes with all the possessions that we afford ourselves: private goods. If we could have more public goods—broad streets of good quality and better police services so that we can feel safer—we would be better off.

It is therefore necessary to question the spending of public money on private goods like cars, steel, hotels, and so on. These are private goods because they can be produced by private businessmen. We do not need to spend the limited amount of tax revenue that we have on building hotels and steel plants. The socialists have invested public money in the largely loss-making public enterprise sector. They make cars but not roads.

India suffers from under-supply of roads: a public good. As already discussed, this has caused “primacy” and the mal-development of our urban areas. We now proceed to discuss the “rationality” of our socialist government that is supposedly “planning” the economy. Every Prime Minister of India is Chairman of the Planning Commission. What is his “rationality”?

Rationality and Political Economy

In Economics it is assumed that all human beings are “rational”. This means that they prefer gains to losses and that they rationally pursue self interest.

In Political Science, for the most part, it is wrongly assumed that all political market actors—politicians and bureaucrats—are pursuing the public interest selflessly.

Political Economy, or Public Choice Theory, takes Economics into Political Science. In Economics we assume that all players in the market are “rational” and pursue their self-interest. What happens if we carry this assumption forward into Political Science and assume that political market players are also self-interested? The results show that: politicians pursue re-election; bureaucrats pursue budget-maximisation, and voters and special interest groups pursue free lunches. This is not to suggest that they are corrupt. Public Choice Theory just assumes that they will act in their self-interest and thereafter tries to assess what predictions can be drawn. If these

predictions of human behaviour in the political market are proved right, the theory is valid. This is also not to suggest that human beings should be selfish always: this is an assumption and not a prescription.

Our planned economy would be “rational” if it pursued policies that gained it maximum revenue. Does our government invest public money in a manner that maximises revenue? In other words: Does our Prime Minister invest our money such that he keeps earning more and more through taxation?

The government invested public money in private goods. . . . They called this a mixed economy. It is really a mixed-up economy.

It is worth remembering that Sher Shah Suri—an Afghan soldier who conquered India with the sword—ruled with the intention of raking in the highest tax revenue possible. He thus built roads and *serais*—the Grand Trunk Road was built by him—for the simple reason that this would encourage trade, which he would tax.

Our socialist Prime Ministers have never believed in trade: that all people are capable of trade. Instead, they restricted trade to promote “industrialisation”. This, today, is called *cronyism*. It is a politico-economic system in which chosen industrialists capture an internal market and keep out foreign competition with the aid of the might of the state.

The government invested public money in private goods. They invested tax money to make cars; they did not invest in roads and allow private businessmen to sell cars. They called this a MIXED ECONOMY. It is really a MIXED-UP ECONOMY. It does not make sense.

The socialists are not “rational.” The manner in which we invest public money must change. Roads must get top priority, because they are public goods. However, highways and expressways can be private goods—through charging tolls—and here it would be better to rope in private investment. Public money should go into funding the best urban and rural roads money can buy. This will make India prosperous. Rural villages, which are unconnected, remote, and poor, will get connected to the throbbing economic engines of urban metropolises. Today, despite all this “rural development” of 50 years, village India is not well connected to urban India, and is therefore poor. As Arundhati Roy says: “India does not live in her villages; India dies in her villages.” If India dumps “rural development,” pursues aggressive urbanisation through a focus on interconnectivity, cities and towns will blossom and we will all live in large houses on broad

streets as more and more land is colonised by roads.

Remember—and this bears repetition—that Japan, West Germany, Belgium and Holland have higher population densities (number of people per square kilometre) than India, and do not face the problem of urban overcrowding as we do. They also report lower prices of urban property. In India, overcrowding and astronomically high rates of urban property are not caused by the “population problem.” They are the result of the undersupply of roads. This is a huge country. Travel by rail or air and you see miles and miles of land without a single house anywhere. This land must be colonised for human habitation. And the way to colonise space is by transportational links, of which roads are the primary means. Connect Village X to Town Y through a tramway—and immediately more land is made available for the citizens of the town. Land prices come down in the city-centre and more people stay a little distance away and commute to work.

We therefore suffer irrational government. Our socialist state spends money foolishly—without scientific thinking behind it. This is all because of its false philosophy regarding people: it does not believe in *Homo Economicus*.

Predatory States and Kleptocracies

Concluding that the socialist state is irrational is surely not enough. We must inquire into the *character* of the state. What purposes does it seek to serve? Sher Shah Suri invested in roads and *serais*, but he was not democratically elected, nor did he plan. His interest lay in raking in taxes—and he achieved this purpose.

Democratically elected socialists who plan the economy have not shown the rationality of a predator like Sher Shah Suri. What could be worse than that?

Many political economists today are wrestling with the concept of the PREDATORY STATE. It is seen that in much of the Third World, poverty persists because the governments are bad. These governments are sometimes also called KLEPTOCRACIES: the rule of thieves. George B N Ayittey has for long been writing about the “vampire states” of Africa. In India, the Prime Minister A B Vajpayee, in a letter to the Lieutenant-Governor of Delhi, has accepted that police and municipal functionaries in Delhi collect over 50 crore rupees monthly by extorting it from street vendors and rickshaw pullers: the smallest players of the market economy. Kleptocracy?

Today, it is an accepted fact that the only reason for persistent poverty and degradation is bad government. Bad governments keep people poor. Why do kleptocracies arise?

As we saw in the case of the Afghan Sher Shah Suri, predatory states are not new to India. The Mughals who followed Sher Shah Suri were also here to maximise their revenue collection. But these states were rational, and they invested in public goods. The Emperor Akbar took 5000 workmen and made a road over the Khyber Pass smooth enough to take wheeled vehicles! In Mughal India, trade was free, as was immigration. Mughal Emperors called themselves *Jahanpanah* or “Refuge of the World”. They taxed trade; and if someone left the protection of a neighbouring King and settled down in Mughal territory the Emperor did not object: for he would collect the taxes now. The Mughal Emperor did not consider the immigrant to be the “population problem”, but a resource that would generate wealth for himself and his Empire. Free trade and free immigration—along with public investment in public goods—allowed these predatory autocrats to maximise revenue and obtain the public interest.

Free trade and free immigration allowed predatory autocrats to maximise revenue and obtain the public interest.

This is again a question of economic rationality on the part of a political ruler. The ruler, say, a small prince, would first maximise his tax revenue by encouraging trade.

Then, he would spend *as little* as possible of that revenue on the people, so that he could pocket the surplus and spend it on himself: his palaces and his banquets. Thus, he would spend on only those things that the market cannot provide. You will see these instances of rational spending throughout India. For example, in most of the old markets of North India, you will find a clock-tower. This would be taken to be a public good. Similarly, Mughal Emperors invested a lot of money on public gardens, another public good. In Mussoorie, on the way to the academy where IAS officers are trained, there is an example of British spending on public goods: a public library.

Contrast this with the socialist democratic Indian state that does not practice free trade (it prefers cronyism), that does not practice free immigration (it believes migrants are part of the population problem), and that does not invest in public goods. It spends all its tax revenue paying out salaries because it wanted to become the biggest employer in the country. Which rational Maharaja would emerge as the biggest employer in his state? Remember, the Maharaja would know that he does not create wealth; he

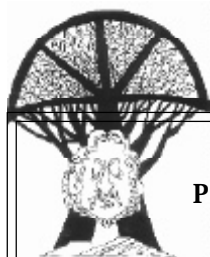
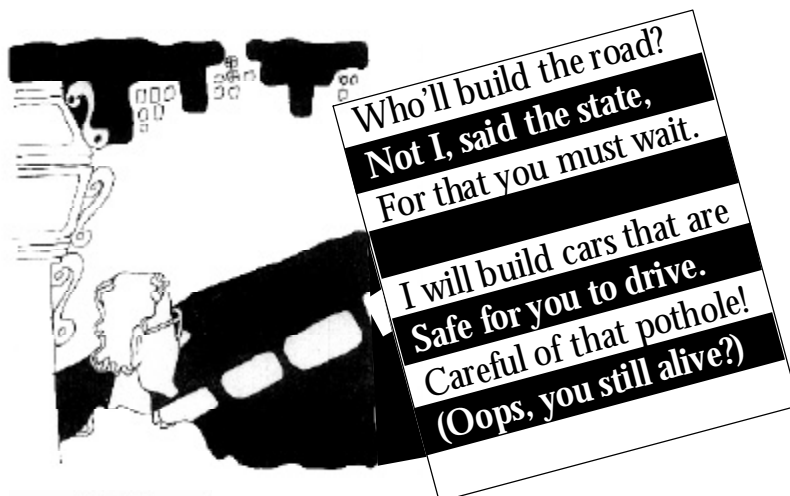
only taxes and spends. Therefore, he would allow the people the freedom to create wealth. The socialist state thinks that it is a wealth creator, and that the best thing that can be done for the people is to recruit them into government service!

This socialist democracy is essentially a KLEPTOCRACY: THE RULE OF THIEVES.

- These kleptocrats protect inefficient private businessmen in return for political favours. Just imagine that today, when a host of multinational car companies have entered the country, our politicians want to keep out second-hand car imports! How long will we continue to see a man, his wife, and their two children going about courting death on a scooter? Should every Indian not own a car some day soon? Why does India have such a huge 2-wheeler industry? China had a huge cycle industry in Mao's times! Socialists all! A second-hand Toyota from Japan or Singapore would cost less than a new Bajaj CNG autorickshaw. Which would cause less pollution? Remember, with autorickshaws, traffic regulation becomes a mess, and traffic slows down, creating more pollution.
- Then, the politicians invest in public enterprises so their henchmen can get jobs and loot public money. They are not interested in maximising the wealth of the nation through free trade, which they can tax.

THIS IS A SPOILS SYSTEM.

We proceed to discuss the relationship between trade and manufacturing. What would happen to Indian industry if trade were free?



POINTS TO PONDER

- Public goods are defined by two characteristics: one, no one can be excluded from their consumption; and two, when some people consume it, there is enough for other people to consume as well. Are education and healthcare public goods?
- Make a list of pure public goods. National defence? Radio broadcasts? Computer software?
- What are your views on privatisation of PSUs? What should be done with the money raised by selling all the public sector enterprises?





chapter 5

The Case for Free Trade

India restricted trade for 50 years, till the World Trade Organisation (WTO) forced change. For 50 years, we could not become “dealers” for foreign manufacturers. Our shops had to stock things “Made in India.” There are still severe restrictions on foreign trade through currency controls and stiff import duties. This is justified by the doctrine of *swadeshi*, which means that we should manufacture all our needs ourselves. We have already found that self-reliance is economic suicide for a human being. Does it make sense for a nation to practice self-sufficiency?

Suppose trade were free and there were open currency competition, and goods from all over the world were available in our markets. Would

this lead to the death of Indian industry? Or would this lead to the *real* industrialization of India?

When goods are freely traded, many of these items would find loyal customers and secure firm markets for themselves. Traders would procure more and more of these goods from overseas manufacturers and ship them into India. The manufacturers would soon see that the Indian market is quite good, and that it is worthwhile for them to shift manufacturing facilities here and save on transportation costs. A manufacturing base in India could also supply cheaper goods to neighbouring markets like Pakistan, Bangladesh, and Nepal.

MANUFACTURE FOLLOWS TRADE.

Traders create markets and manufacturing follows to service these markets.

From the Indian point of view, the best example is of the North-East. It is the most underdeveloped part of India. We want it to be “developed”. We want it to be “industrialised”. How do we attempt the task? We could close it down to the world outside and attempt to prop up domestic manufacture. Some small factories would come up.

Or we could internationalise the economy and let our energetic trading communities flood the region with all that money can buy. Now, the people of the Northeast will soon show a marked preference for certain things—say, instant noodles—and the manufacturers of these goods will soon put up plants there. Traders work both ways, many would find overseas markets for the produce of the Northeast.

There are many examples of this in liberalised India, but perhaps the best example is one of DIRECT MARKETING COMPANIES like Amway, Tupperware, and Oriflame. They operate on the assumption that each Indian is a trader and they recruit ordinary people to be their dealers and sell their products among their friends and associates. Thus, they build an army of part-time traders. Without any advertising, they manage to secure market shares. Today, all of them are manufacturing in India. It may be that they have been forced to do so by the government, but even if they had been left free, they would enter local manufacturing once the market proved itself. Further, having learnt from these overseas players, an Indian company has begun direct marketing: Modicare. All these positive effects followed from free trade.

Free Trade in British India

This phenomenon also made itself felt in British India. The British operated a free market economy till 1914, the beginning of World War I. In 1914, India was the world's largest importer, not of British textiles, but British *textile machinery*! That is, India was becoming a major textile manufacturer!

The 1919 Report of the British Trade Commissioner noted that many of the great merchant firms which dealt in engineering goods manufactured in Britain had themselves started manufacturing in India, and were now reluctant to sell the products of their principals back home. They had started off dealing in engineering goods made in Britain, but now they had established good local markets, begun local manufacturing, and would much rather sell what they themselves manufactured in India.

In the modern, globalising world economy, free trade will boost India's chances of becoming a world-class manufacturing centre. The trend has already made itself felt, as global manufacturers seek the cheapest production locations closest to their biggest markets. Giant toy and athletic footwear companies are maintaining small design and marketing offices in the US and Europe but getting all their manufacturing done by contract in the Far East. Publishers are doing editing and proof-reading at home, leaving labour-intensive typesetting and printing to contracted parties in Taiwan and Singapore. India is a big market. India can become a world manufacturing power. For this, all she has to do is practice free trade and invest in her infrastructure.

To clinch the argument, let us take the case of the laundromat. It exists in every city in the developed world. The laundromat is equipped with a large number of heavy-duty washing machines and many heavy-duty clothes driers. People take their dirty clothes to the laundromat, push coins into the machines, and soon they are back home with everything clean and dry.

Now, these heavy-duty machines are not manufactured in India despite the fact that the market for domestic washing machines is saturated with too many competing players. Instead of laundromats, Indian cities have *dhobies*. With free trade, including free trade in second-hand goods, India would be flooded with laundromats and most of our *dhobies* would obtain credit from private banks to own and operate them. People living in high rainfall and humidity areas would come to appreciate the clothes

drier and a market for these goods would be created. Not only would our *dhobies* enter the modern world; very soon, local manufacturing of these goods would start. Today, without free trade, local manufacture is risky. The market is uncertain. Advertising is expensive. If traders are allowed to establish markets for manufacturers, factories would erupt all over India.

Of course we will need sound infrastructure. No one will put up a factory where there are no roads and electricity, and where there are no efficient ports, airports and railways. Big international companies will want to put up manufacturing plants in India because labour is cheap; but the infrastructure will make them run away. Improving the infrastructure requires massive PRIVATISATION and public investment in PUBLIC GOODS like roads and law and order. Good policing, fast-acting courts, good roads and an excellent privatised public utility sector providing electricity and water will attract the world to set up manufacturing in India.

We do not need IMPORT RESTRICTIONS to become a world-class manufacturing country. *Swadeshi* is economic suicide. We need FREE TRADE and BASIC INFRASTRUCTURE.

Free Trade and Agriculture

Free trade in agricultural products is opposed by many in the name of “self-sufficiency in food” or “food security.” Indian farmers are supposed to produce all of India’s needs. Is this a good idea? Or would we be better off importing those agricultural products which we do not produce efficiently ourselves? Let us examine the issue:

If trade were free, there would be many areas where India could gain by importing: for example, cheap wheat from the prairies and cheap sugar from Mauritius and Java. We do not produce wheat and sugar as efficiently as them. What would Indian farmers produce?

Indian farmers, with their small farms, would be better off producing fruits and vegetables for the world. An apple sells for Rs. 1500 in Tokyo; a musk melon for Rs. 4000. If Indian farmers specialised in high value fruit and vegetable production and imported wheat and sugar they would be better off. Of course, this would require very good infrastructure, so these farmers could easily send their perishable products to international markets.

In my travels around India, I have often found exotic fruit rotting in villages: custard apples in Karnataka; peaches, plums, and strawberries in

Uttaranchal and Himachal; litchees and mangoes in Bihar; and pineapples in the North-East. Today, there are farmers in Jharkhand specialising in flowers. I met an old lady in the Kumaon hills who specialised in growing garlic in her small plot of land, and this was enough to keep her going. What matters most for farmers is freedom: freedom to access urban markets and freedom to access technology. With good roads, and freedom, free trade will enable India's farmers, with their small plots, to participate in the INTERNATIONAL DIVISION OF LABOUR and prosper like never before.

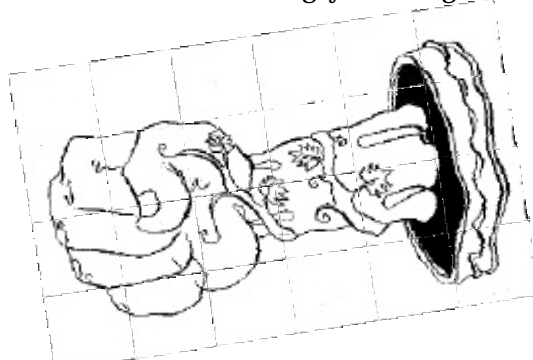
Remember another thing: our farmers who produce wheat and sugarcane do so with subsidised inputs like power, fertiliser and water. If these inputs were properly priced, they would be out of business. It makes no sense to freely provide power, water and fertilisers to farmers who use them inefficiently. The free supply of power, water, and fertilisers causes their excessive use, with more drain on tax revenues. This also damages the environment.

Indian agriculture is also ridden with extreme restrictions: farmers are not allowed to sell wherever they please. These restrictions are extremely harmful to farmers and only benefit the KLEPTOCRACY.

THERE IS THEREFORE NO LOGICAL REASON WHY POLITICAL POWER SHOULD BE USED TO PLACE RESTRICTIONS ON OUR NATURAL ABILITY TO TRADE FREELY IN THE MARKET ECONOMY AND CREATE WEALTH FOR OURSELVES.

ECONOMIC FREEDOM IS OUR BIRTHRIGHT.

When free trade is mentioned, many people talk of the shortage of foreign exchange. We will find that, if we had SOUND MONEY, we would have no reason to fear the bogey of foreign exchange shortages.



Watch Guptaji's travelling circus,
Zigzagging through busy streets
Heaped higgledy-piggledy on one scooter
Performing incredible feats.



Watch the state ban free car imports
That would give us used cars cheap
And prevent poor Guptaji's family of six
Getting crushed in a terrible heap.



POINTS TO PONDER

- Swadeshi would imply a cosy inter-relationship between the government and Indian manufacturing interests. Would this relationship be honest or corrupt?
- Customs duties are levied on almost all goods imported into the country. Do these taxes make any sense to consumers?



chapter 6

Sound Money I

How humans, and not governments,
invented money

Money is one of the greatest inventions of the human mind. It was not invented by the State. Today, we simply accept government paper as money and think that is all there is to money. The fact is, this government paper is not good money. If you look closely at a rupee note, you will see that it bears a promise “to pay the bearer a sum of X rupees.” But if you take a 100 rupee note to your bank and ask for dollars in exchange, the law of the land decrees that you should be jailed! To understand the difference between good and bad money, we must look into the history of the development of money.

Money solves a specific problem in barter: THE DOUBLE

CO-INCIDENCE OF WANTS. If you have potatoes and want apples, you must find someone with apples who wants potatoes. If you find someone with apples who wants onions, you cannot trade.

Money evolved naturally to solve this problem. It was not created by the government.

What happened was that certain goods were seen by all to be MOST SELLABLE. These were the goods that moved fastest in the market; which most people would most readily accept.

That is, all commodities can be ranked according to how easy it is to sell them. If you took 100 stereo systems to market, it might take you a few weeks to sell all of them. If, on the other hand, you took 100 potatoes, or marbles, or cigarettes, you would get rid of your stock within hours. THE MOST SELLABLE COMMODITY AUTOMATICALLY BECOMES MONEY.

To put the point across another way, let us take the case of an economy with only two goods: potatoes and wheat. Now, they exchange for each other at a known price: a rate of exchange. Now, suppose a third good was to emerge: deerskins. Now that there are three goods, a natural pricing of each in terms of the other would emerge. Everyone would soon know what wheat and potatoes are worth in terms of deerskin and vice versa. Now, one important role that money plays is as a STORE OF VALUE. You cannot store potatoes and wheat indefinitely, but you can do that with deerskins. It is therefore quite likely that in this economy, deerskin would emerge as money. People would take deerskin to market to get potatoes and wheat. And they would store their wealth, in deerskin, at home.

In the US, in the early days of the new settlers from the Old World, buckskin did emerge as money: the word “buck” for money comes from that. That is how the phrase “how many “bucks” is something worth” came about!

Throughout history, various items have served as money: cocoa beans, animal hides, cowrie shells, tobacco leaves, and—of course—metals like iron, copper, gold and silver. Roman soldiers were paid their wages in salt, hence the word “salary” and the expression “not worth his salt”. In my boarding school, glass marbles played the role of money. In Nazi concentration camps, prisoners used cigarettes as money. These are called HARD MONEY. They are *not* TOKEN MONEY. The object in question

that serves the purpose of money has its own *intrinsic value*: the money itself is worth something. Paper money is token money. From this history of money it is possible to say today, with confidence, that barter economies never existed. Once the number of commodities grows, something or the other always emerges as money, naturally.

Paper money was invented by goldsmiths. At first, the goldsmith would stock your gold for you and give you a signed paper receipt. So, when you had to make a purchase, you would carry that receipt to the goldsmith, collect your gold, and head for the market.

People soon realised that instead of going to the goldsmith each time they wanted to use their (gold) money, they could simply give the receipt signed by the goldsmith to the merchant. By showing the receipt, the merchant could collect the gold from the goldsmith. The receipts were

**Government control
over money issue
gives rise to the
problem of
debasement.**

freely used as token money—they became BEARER NOTES! Anyone could take the note to the goldsmith whose signature was on it and collect the gold. This made it possible for people to freely use token money. The notes were passed around in the market, and these bearer notes of innumerable private goldsmiths were money.

There were competing private note-issuers issuing money, with no government control. This was the period of “free money.”

Government control over money issue gives rise to the problem of DEBASEMENT. To understand this phenomenon, go back some centuries in time and imagine yourself as the King of Shangri-La.

If you were a good king, you would mint coins of the highest purity so that your face would travel to all parts of your kingdom—and to the world beyond—and symbolise honesty and integrity. The Hapsburgs of Austria minted a pure gold coin called the Reichsthaler. It was the most popular coin in circulation in North America, and it is from the “thaler” that the word “dollar” is derived.

If you were a bad king you would mix some BASE METAL like brass into your coins and/or reduce their weight marginally. This is DEBASEMENT. The immediate effect of debasement is to increase the number of coins you can issue. Instead of 5 tonnes of pure gold coins you would issue 6 tonnes of debased coins. The bad king of Shangri-La would spend his extra coins on wine, women, and war.

Debasement, by increasing the QUANTITY OF MONEY (from 5 tonnes to 6 tonnes) raises prices and causes INFLATION.

History is full of examples of governments issuing bad money: The powerful Roman Empire collapsed because of debasement. To understand how, let us travel back even further in time and imagine ourselves in a south Indian village where cowrie-shells serve as money. Now, imagine that, walking on the beach one day, you discover an enormous trove of cowries washed up by the sea.

Suddenly, all your dreams have come true. You can go to the village square and buy all that money can buy. You rush with your cowries to the market and spend a lot of them. You get land, a house, food, drink and cattle... whatever you wish. But, consider the LONG-TERM EFFECT.

Your good fortune would be everyone's good fortune. Landowners, labourers, cattle-ranchers, agriculturists, merchants—all would rake in the money you have spent and then go out themselves, making their own increased purchases. The DEMAND for everything would rise. SUPPLY would remain the same. PRICES would thus rise, of everything: INFLATION.

In effect, the price of cowries would go down because there would be a greater abundance of them. If, instead of cowries, you had found a hundred crabs and took them to the market, the price of crabs—in terms of cowries—would fall. Similarly, when you find cowries, the price of cowries—in terms of crabs (or anything else)—falls.

Inflation is the fall in the value of money due to increases in its quantity. This is known as the "quantity theory of money."

There are two characteristics of sound money: stable value (or the absence of inflation) and free convertibility. On both counts, the Indian rupee falls flat, as do the currencies of most Third World countries. Nowadays we keep hearing of currency collapses. All these are currencies issued by Third World governments. All this is unsound money.

The socialist Indian State destroyed the Indian rupee by printing it in excess. They call this DEFICIT FINANCING. This means that, when they are short of tax revenue to meet their expenditures, they simply print extra notes and use them. This naturally causes INFLATION: the quantity theory of money. The state thereby rakes in the INFLATION TAX, for when it spends the extra money the state gets real goods from people at today's prices. However, when these people spend this money, the prices

***Did you know that
hyper-inflation led to
the rise of Hitler in
Germany and of Mao
in China?***

have risen, and they get less real goods. The inflation tax is a way the state cheats us out of our money—in our pockets, bank accounts, pension, and provident funds. We invest, say, a lakh of rupees in the Public Provident Fund at 10 per cent interest. The state causes 7 per cent inflation. In effect, therefore, it pays out only

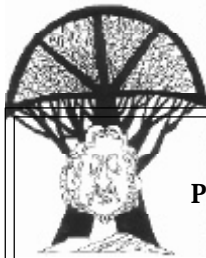
3 per cent interest. The rest is the inflation tax.

Now, most of this money is spent on bureaucratic budgets, which refuse to climb down because bureaucracies rationally maximise budgets, as already discussed. This money is also spent on the loss-making public sector. It is not spent on public goods. But there is something worse. Our banking system is entirely politicised. Most Indian banks are government-owned and they report huge losses. We turn to how this affects the soundness of the rupee.

Once cowrie shells
Kingsize cigarettes
Even potatoes
Paid off your debts.

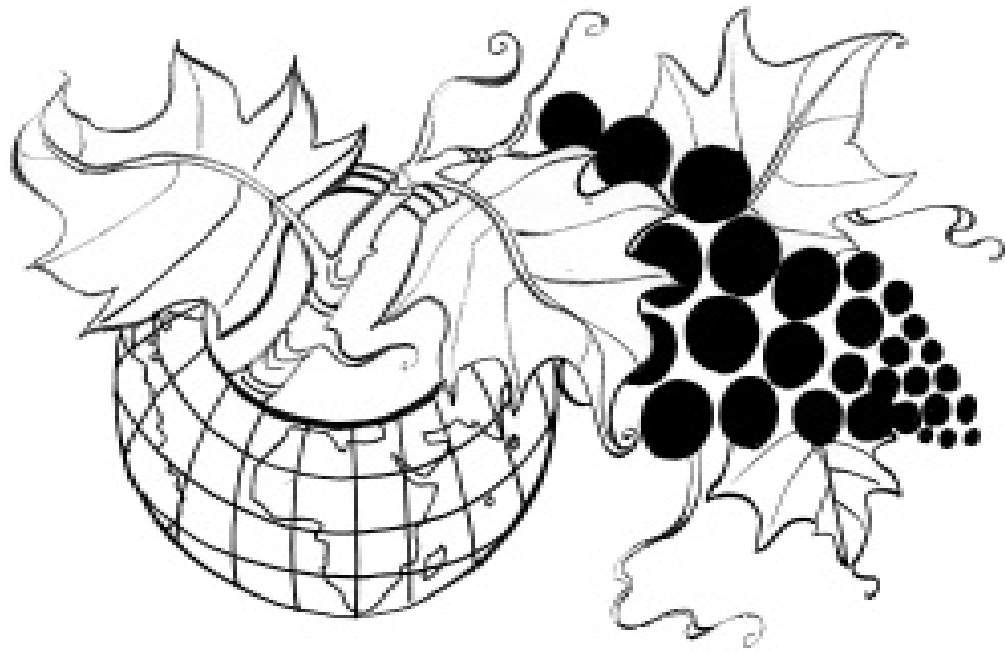
Now paper does—
Rupee, mark, and pound.
The million dollar question is:
Is the money sound?





POINTS TO PONDER

- Do some private research into the various commodities that have played the role of money throughout human history.
- Do some research also into Greek history, inquiring into the first city-state to mint coins, and study the effects this had on the commercialisation of society.
- Find out the story of the end of the Roman Empire and debasement. Are there any instances of foolish monetary experiments in Indian history?
- Construct a flow chart to explain how the inflation tax works. How is inflation tax similar to income tax?



chapter 7

Sound Money II

**Credit creation and the evil
that is political banking**

Having understood the origins of money, let us proceed to the subject of CREDIT.

Creditworthiness is something real and tangible: some possess it, some don't. When I go to my neighbourhood market, where all the shop-owners know me, I often get credit. The fish merchant is happy to push a big *ilish* on to me—even though I have less money in the wallet—knowing well that I shall pay up some day. The cigarette vendor knows me and gives me my cigarettes when I have no ready cash. Not everyone gets this credit, because not everyone is creditworthy.

The same applies to a credit card. When I was a freelance journalist,

no credit card company would grant me membership; when I had a regular job they were all falling over backwards to make me a cardholder.

When credit goes to the creditworthy, all is well, and the economy gallops along. This, however, is not the happy outcome when governments interfere in the banking system and direct the allocation of credit. Then, credit goes to the preferred clients of the finance ministry. These are not so creditworthy. The nationalised banking system is thus heavily burdened with NON-PERFORMING ASSETS (NPAs). These should simply be called LOOT by the credit-unworthy.

When a bank has too many bad debts, it goes bankrupt. But here, money is pumped in (as in the case of the Indian Bank) from the exchequer. This is public money going down the drain.

When too many banks are burdened by bad debts, and the central bank has issued too much currency, there is no choice before the government but to keep the currency inconvertible. If India wants sound money—that which is freely convertible and of stable value—she has no choice but to privatise the banking system and take the finance ministry out of the allocation of credit.

Private allocation of credit is not only efficient, it promotes moral behaviour. To continue to enjoy credit from the cigarette vendor and the fish merchant, I have to ensure that I clear all my debts in time. If I fail, credit can be suddenly withdrawn. If I do not clear my credit card dues every month, the card-issuing company will cancel my card. On the other hand, with political allocation of credit, money is diverted to those who have “links” with politicians and bureaucrats. This promotes bribery and corruption. And honest borrowers do not get credit. It also weakens the banking system, making it prone to collapse. In the recent East Asian crisis, it was CRONYISM that caused their currencies to collapse. Their banks had lent heavily to “friends” of those in power. When these firms collapsed, they took the entire banking system, and the currency itself, down with them.

There are thus pressing reasons for getting governments out of the banking system and the issuing of currency. They misallocate credit and they debase currencies. Since ours is a democratic state, there is all the more reason to take away its ability to print money and allocate credit to itself. Democratic governments are supposed to represent taxpayers. “No Taxation

Credit raj is worse than the license-permit raj because it can lead to currency collapse in the case of an open economy.

without Representation” has always been the rallying cry of democracy. But democrats cease to represent taxpayers when they have the ability to produce money out of a hat. When they can do so, they no longer care about their taxpayers and instead use the printed money to cultivate VOTE BANKS.

There are five ways by which sound money can be obtained without political control:

- Currency boards: as in Hong Kong, where the monetary authority allows private banks to issue Hong Kong dollars at a fixed rate of exchange with the US dollar
- A variation of this is a gold-based board, which keeps gold and issues currency according to the value of the gold
- Independent monetary authorities which are free of political control (if that is really possible)
- Transnational monetary authorities, for example the one issuing the Euro, which is representative of various governments
- Private sector money

Of these, private sector money is the one that is being increasingly preferred by scholars. The reason is that no-one would accept private money if it was not convertible on demand into a base asset—be it gold, silver, platinum or a packet of cigarettes. Money would therefore always be HARD MONEY. Irredeemable papers—the kind governments print today—are not good money.⁴

The arguments that free trade will affect “precious foreign exchange reserves” is therefore faulty. If you gave up your gold and imported a Ferrari, the deal was worth it to you. It is your money that went out. It is your

When money is sound, it does not really matter where it is going so long as real goods are coming in.

Ferrari that proudly stands in your driveway. When money is sound, it does not matter where it is going as long as real goods are coming in. In the case of a currency board, if you give up HK\$ 1000 to a US company, the board always has the US\$ to back you. That is sound money. It enables free trade. The “precious foreign exchange” argument is only used by those who have

⁴ For a more detailed discussion on private money see my *Antidote: Essays Against the Socialist Indian State* (Macmillan, New Delhi, 2000). Also see Professor R K Amin's *Money, Market, and Marketwallahs* (Centre for Civil Society, New Delhi, 2002).

issued so much local currency that they do not have reserves to back it. Our Reserve Bank is actually quite broke. Thus, laws like the draconian FERA (Foreign Exchange Regulation Act) are immoral. When the central banker cannot convert his paper notes into the underlying asset it is the central banker who should go to prison: a debtor's prison. What else is meant by the promise on each note?

To understand this better, look sometime at the vegetable vendor who takes his cart from locality to locality. He ultimately gets rid of all his vegetables and makes off with his customers' money. Is he a public enemy? After all, he is making off with public money. But the answer is clearly "No." He has taken money, yes, but he has left vegetables behind. The customers are all better off because they prefer possessing vegetables to money and the vendor is also better off because he prefers holding money to vegetables. Trade is a positive sum game: both sides win.

Go to any market and you will see hordes of people coming in with money, leaving the money behind, and walking off with a host of goods. Are all the shopkeepers in these markets enemies of society? Certainly not. In an internationalised economy with free trade and sound money, a lot of money will go out, but a lot of goods will come in. Both sides will gain. No one will lose.

When you go to a shop and buy something, say a book, you say "Thank you" to the shopkeeper when he hands you the book. The shopkeeper also says "Thank you" to you when you hand him the money. The very fact that *both sides* thank each other shows that both sides gain. Trade is a positive sum game. Always remember that.

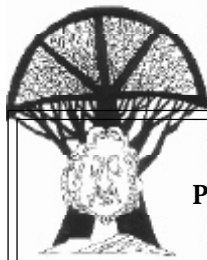
When generous loans are not returned

Nobody really cares.

They're simply running the banks you know—

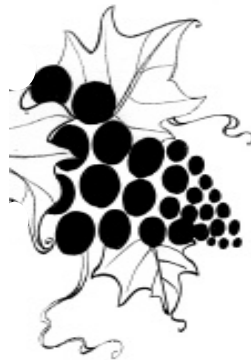
The money isn't theirs.





POINTS TO PONDER

- Examine the truth in the statement: Banks create credit.
- Why are there so little repayment defaults in car and housing loans?
- Try and imagine a situation when everyone has the power to issue IOUs. Whose IOUs would you accept? What would you expect the IOUs to be redeemed in?





chapter 8

Employment

A: Employment Generation

The Government of India spends a great deal of money on EMPLOYMENT GENERATION. This is really how a KLEPTOCRACY diverts money from public goods. Note that the money is spent by bureaucrats on politicians' "projects." They are spending tax money (and dishonestly printed money: deficits) ostensibly fruitfully. The truth is that these "employment generation schemes" are nothing but *schemes* by which public money is stolen by the major players of the political market.

Government spending cannot create more employment than private spending. If taxpayers had kept the money (instead of paying taxes)

and spent it, the same amount of employment would have occurred.

If taxpayers had saved the money in private banks, which then made sound commercial loans with the money, the same amount of employment would occur.

KLEPTOCRATS, instead, print money to finance these “schemes.” They rake in the INFLATION TAX. They are not helping anyone, least of all the poor. These schemes should be stopped and all public spending focussed on public goods. We do not need this great conspiracy of thieves called “employment generation.”

B: The Khadi Fallacy

Most members of India’s political class wear *khadi* to show their allegiance to a philosophy which holds that machines cause unemployment and, therefore, if we use LABOUR-INTENSIVE methods of production we can maximise employment. They also believe that this method of employment creation, through avoiding the use of modern machinery, makes sense in a country which they see as overpopulated.

This argument neglects PRODUCTIVITY and EFFICIENCY. Division of labour is the method of producing wealth. It creates niches in which we operate. In each of these niches we try to produce the most with the least application of labour: this is rational, industrious Man pursuing wealth. If it makes sense for him to use a machine to help him in his task, why should the nation lose? Do machines cause unemployment or do they create more wealth by producing more and more goods with less and less effort? What is the truth? What do you think, looking around you? Would we all be better off in the Stone Age—all gainfully employed using stone implements?

Machines produce more and thereby cause ABUNDANCE. This lowers the price of the good produced and more and more people can afford it. The market expands and employment is finally higher than it was at the point before the machine was introduced. The best example is the car.

When Henry Ford began his assembly line method of producing cars, he pursued PRODUCTIVITY. He produced more cars in the same amount of time using more machines and less labour. Soon, cars became cheap and more people could afford them. The market expanded.

Today, most automobile plants, all over the world, including India,

are highly automated. Yet, employment in the automobile industry is far more than it was in Henry Ford's day.

A little joke is told about this fallacy:

One day, two workers were watching a giant earthmover scooping out mounds of earth in its giant maws.

Said one: If it were not for this machine, a thousand of us could have done this work with spades.

Said the other: Or a million, with spoons.

Economic Freedom Maximises Employment

Employment occurs when real goods and services change hands. The government cannot create employment: it can only tax and spend. Employment will occur, then, only if the economy is free and people are not obstructed in their economic activities by government *babus*. Trade restrictions, currency restrictions, license-permit *raj*—all these should go. In a poor country, people must be given freedom to make money honestly, satisfying the needs of their fellow beings.

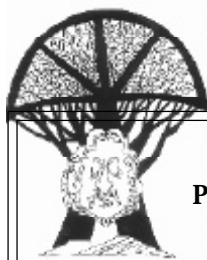
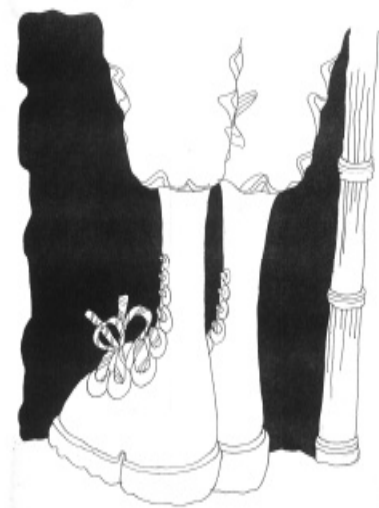
What about unemployment in “rural” areas where there are lots of “landless labourers” and “marginal farmers?” Well, the truth is that these people are living in self-sufficiency and are doomed to remain forever poor. They have no surpluses which they can take to market. It makes no sense to spend money “generating” employment in rural India. It makes far more sense to build a nation of 500 free trading cities and asking these poor people from the villages to migrate to the cities and take part in the greater division of labour possible there.

The share of agriculture in national income will always decline as the country advances, and services and manufacturing overtake agriculture. If more and more people are left dependent on agriculture, they will be doomed to eternal poverty. Urbanisation is the best thing that can be done for the rural poor.

With free trade, even if they run little roadside shops, they will find “employment.” Today, we have a Ministry of Urban Development and Poverty Alleviation and the system extorts money from street hawkers and vendors. The freedom to operate in urban markets is all that the poor really need. For the sake of the poor, the state must get out of the market.



Beaten,
 harassed,
 hounded,
 robbed—
 The system is out to get him.
 How can the hawker earn a living
 When the predatory state
 won't
 let
 him?



POINTS TO PONDER

- If you were the Mayor of a town, what policies would you put in place to ensure that the people were employed?
 - Would you print money and spend it?
 - Would you start giving out a dole to the unemployed?
 - Would you pay people to dig ditches and then fill them up?
 - Did you know some people thought that World War II was a solution to the Great Depression?
 - Or would you maximise economic freedom and let people attempt to look after themselves?
- Consider the vast improvements that have taken place in textile technology. Is the *khadi* philosophy good for the country?
- Do some research into the Luddites who used to go about smashing textile machinery in England during the Industrial Revolution in the belief that these machines were the enemies of the poor.