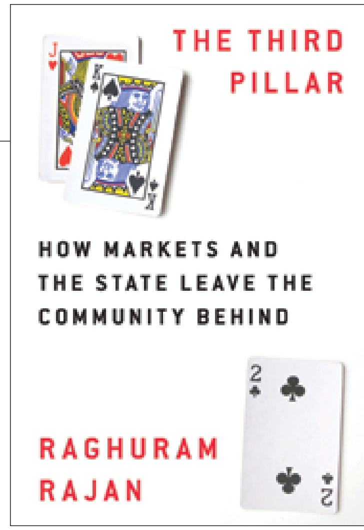
Fixing Capitalism

MARKETS AND THE STATE have long competed to control what Lenin called the commanding heights of the economy. After the Berlin Wall fell, markets seemed to reign supreme. Even many on the left, traditional supporters of a strong state, became champions of free markets. The brilliant economist Larry Summers professed "grudging admiration" for Milton Friedman and, while at the US Treasury in the 1990s, pushed for financial globalization, the free flow of capital across national borders.

Raghu Rajan never succumbed to the euphoria. While a firm believer in free markets and their benefits, he has been vocal about their costs. In *Saving Capitalism from the Capitalists* he wrote that the victims of competition should get help to ease their pain and secure their future: "Markets need a heart for their own good." In 2005, in a now-famous speech, he warned that the excesses of financial globalization raised the odds of a "catastrophic meltdown," earning a rebuke from Summers that Rajan was "slightly Luddite" and "largely misguided."

The global financial crisis and recent discontent with globalization have proved Rajan prescient. His latest book attempts to go beyond warning of the dangers of unfettered capitalism to what can be done to fix it. Rajan suggests restoring the third pillar of society, the community, which he defines as a social group residing in a specific area that shares government and often a common heritage. Markets and the state remain indispensable, but "when the three pillars of society are appropriately balanced" … "society has the best chance for providing for its people," particularly those who lose out from the effects of trade and technology.

Rajan points up the damage from international trade. US job loss from increased foreign competition, for instance, has contributed to lowering the life expectancy of middle-aged non-Hispanic white males. "It is as if ten Vietnam wars were simultaneously taking place, not in some faraway land, but in homes in small-town and rural America," Rajan writes. Yet these communities' fate was largely neglected by the mainstream establishment parties, who Rajan laments "do not even admit to the need for change" and tend to castigate losers from the



Raghuram Rajan
The Third Pillar: How Markets and the State Leave the Community Behind
Penguin Press
New York, 2019, 464 pp., $30.00

effects of trade and technology as belonging to a basket of deplorables.

Rajan of course knows that communities too can pose dangers. The book contains a fascinating account of how markets and the state overcame the shortcomings of feudal communities, which provided stability but did little to spare most from abject poverty. Modern communities also erect walls, and overemphasis on tradition and fear of strangers and new ideas can leave people "trapped by the past."

Power must devolve from global and national levels to the community.

Still, Rajan argues, markets and the state have usurped communities' power, and the balance needs to be reset. Power must devolve from global and national levels to the community. Rajan notes that as machines and robots begin to produce more of our goods and services, human work "will center once again around inter-personal relationships." Communities could well be the workplace of tomorrow. FD

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Free exchange

A new book argues weakened communities threaten liberal democracy

Raghuram Rajan's "The Third Pillar" says that society matters

Feb 21st 2019

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UNTIL RECENTLY, economists’ prescription for struggling places was bloodless: let them die. “Some towns cannot be preserved”, this newspaper argued in 2013, attracting a larger-than-usual volume of correspondence from dissenting readers. But the electoral successes of Donald Trump and the campaign to yank Britain out of the European Union (EU) have shaken the dismal science. Prominent economists have begun to consider what an efficient response to geographic inequality might look like. In a paper published in 2018, for example, Benjamin Austin, Edward Glaeser and Lawrence Summers of Harvard University argued for employment subsidies targeted at struggling places.

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The reconsideration of place-based policies can often seem grudging—something to be tolerated, in order to keep those on the losing end of regional inequality from embracing populism or killing themselves with drugs. Economists’ reluctance is understandable: efforts to help struggling communities might well deter people from moving when they would otherwise have relocated to more promising places. But it is also short-sighted, argues Raghuram Rajan, an economist at the University of Chicago and the former head of India’s central bank. In a compelling new book, “The Third Pillar: How Markets and the State Leave the Community Behind”, he argues that communities are not so much a source of friction inhibiting the smooth operation of the global economy, as an indispensable part of a healthy society.

Mr Rajan believes in markets but has often made himself the bearer of awkward economic news. In 2005 he soured the mood at an annual conference of central bankers by asking whether financial innovation had made the world a riskier place. In a book published in 2010 he argued that the policies that unwittingly led to the global financial crisis, for example mortgage subsidies, were often responses to economic "faultlines", such as inequality; those faultlines are still in place, ready to wreak future havoc. "The Third Pillar" similarly urges economists to recognise a blind spot. The places where people grow up, live and work are not simply agglomerations of economic activity. They shape people's identities and "anchor the individual in real human networks". Communities provide leverage to those who might otherwise find themselves bullied by the state or by markets. Their function has changed dramatically since pre-industrial times, but communities remain a critical piece of social infrastructure.

That community matters might seem a banal observation to non-economists. But it sits inconveniently alongside many aspects of an economist's worldview. Economic progress has often meant the replacement of personal, community interactions with efficient but more impersonal ones. The less sentimental people are about where they live or who they work for, the more readily they can move in response to market pressures, boosting productivity and limiting the damage from creative destruction. Community-based economic activity, by contrast, can be inefficient. Lending a friend money or caring for an ailing relative seem like nice things to do. But larger and more transparent financial markets attract more funds and expand access to credit, while a market for care work allows for welfare-enhancing specialisation and trade.

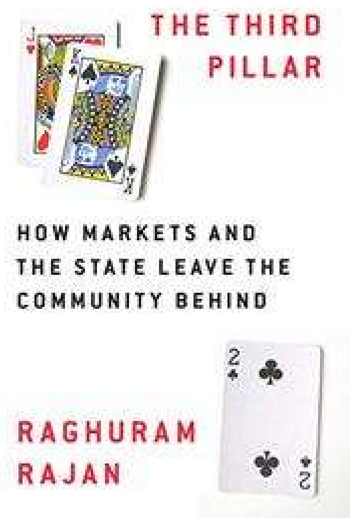
Mr Rajan acknowledges the negative effects of tight-knit communities. The book provides a short history of the evolution of community, state and market in Europe, which begins in the stifling world of the feudal manor. Community relationships governed nearly every aspect of life, maintaining order and stability at the cost of economic stasis and oppression. Disruptions to that world created the conditions for the maturation of the state, and for economic progress. As the world became more interconnected, states and markets assumed roles once played by the community—from insuring against hardship to funding investment.

Communities today can still be intrusive and intolerant. But they also provide support, inspiration and a backdrop for people's emotional and spiritual lives. Communities, furthermore, are where the abstractions of global economics and politics become real. Strong states and deep markets might have enabled unprecedented prosperity and individual liberty, but they are prone to excesses. It has often fallen to communities to correct imbalances of power. Mr Rajan points to social movements, born of community action, that were responsible for the spread of primary education and the expansion of the franchise.

I think we're alone now

The past half-century has been difficult for the third pillar, however. Globalisation and technological change have deprived many places of sources of employment and wealth. Regions' fates seem increasingly determined from afar, by supranational organisations like the EU or by fickle global financial markets. Trade and technology have transformed many industries into winner-takes-all affairs. Opportunity has become concentrated in expensive superstar cities, which attract the most talented members of communities and leave everyone else without such opportunities. Mr Rajan reckons that the weakening of communities that has followed these trends makes the world vulnerable. The frustrated residents of struggling places mistrust elites, and seek meaning instead in the ugly politics of populist leaders.

Promising solutions are hard to come by. Still, Mr Rajan offers reasonable recommendations. Devolution of policymaking authority might invigorate community spirit. Governments should also practise "responsible sovereignty", he reckons, and limit unnecessarily disruptive forms of economic integration, like reckless financial globalisation. But the thrust of "The Third Pillar" is that society matters after all. Having been insufficiently mindful of this over the past few decades, business and government leaders may have little option but to brace themselves for frustrated communities demanding change.



THE THIRD PILLAR

How Markets and the State Leave the Community Behind

by Raghuram Rajan

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Capitalism builds private fortunes—often at the expense of the polity.

Communities—tribes, neighborhoods, and kindred social structures—are the basis of human commerce and the marketplace. Yet, writes Rajan (*I Do What I Do*, 2017, etc.), former chief economist and director of research at the International Monetary Fund, markets and the state alike have assumed many of the roles of traditional communities. By way of example, he writes that whereas in years past, we might have taken an auto-less neighbor to the grocery store, “today, she orders her groceries online.” The insistence on credentialing is one cause, with licensed professionals dominating many services that were once done within communities. While there are reasons of liability and public health at play, Rajan notes that the one-off transactions of today do not have the same network-building value as the repetitive, within-community transactions of old; “only individual interests matter, and they have to be met transaction by transaction.” This zero-sum economic scenario is especially prevalent in poor communities, but it is not inevitable—though it has a long historical basis in the replacement by modern structures of capitalism for the “reciprocal feudal obligation” of the pre-capitalist era. Strong communities, argues the author, can promote democracy and contain crony capitalism and corruption, just as healthy markets can contain the authoritarian impulses of the state. In that regard, democracy, capitalism, and community need not be mutually exclusive propositions even if the modern American emphasis on the market has produced profound inequalities that might have been tempered “by sensible government regulation.” Inequality yields radical populism, which yields authoritarianism, all, again, working against community. Rajan is sometimes repetitive, but his emphases seem well-placed, especially because we can see so much of his argument playing out in daily life, with private interests ascendant and the public good untended.

A welcome survey of a big-picture problem: Rajan proposes a rebalancing to be brought about by decentralized politics, diverse immigration, and other measures that, though controversial, certainly merit discussion.