

The Third Pillar: How Markets and the State Leave the Community Behind by Raghuram G. Rajan, 464 pp., HarperCollins Publishers India (2019), ₹799.

A development model that could deliver inclusive and sustainable high growth, enhancing economic prosperity for all on a sustained basis remains largely elusive. Responding to this challenge, leading strategic thinkers in the field of economics and finance have come up with innovative ideas. A prominent feature of the extensive debate on this subject so far has been ‘markets *vis-à-vis* state’, not in the sense of a dichotomy between them, but more as an optimal combination of the two. While the markets are believed to ensure efficient allocation of resources that is necessary for higher economic prosperity, the state can enforce regulations enabling markets to function effectively, provide a level playing field to market participants, and undertake redistribution to address inequality. In this insightful book titled *The Third Pillar: How Markets and the State Leave the Community Behind*, Raghuram G. Rajan sheds light on the often neglected third pillar of society—the community.

The book begins with a description of the community, illustrating its benefits and shortcomings through relevant case studies. The community performs a number of roles. It gives individuals a sense of identity and belonging; it supports members in times of social and economic distress; it allows members to participate in local governance structures thereby improving the provisioning of public services while giving members a sense of control over their lives. In fact, vibrant communities can serve as a watchdog to prevent corruption and crony capitalism by mobilising protests. Notwithstanding its usefulness, the community can also be regressive if community members put too many restrictions and over-emphasise traditions to protect the power structure within the community. Thus, what is needed is the right balance between the three pillars: state, markets and community in order for society to prosper.

This book is divided into three parts. Part 1 provides a historical narrative on the evolution of the three pillars of society. It begins with a discussion on feudal society in medieval Europe, tracing developments in society till the

Great Depression. Part 2 of the book examines the interaction between the three pillars against the backdrop of the Second World War and the Information and Communications Technology (ICT) revolution. Rajan also briefly touches upon the imbalances building up in the two fastest growing large economies: China and India. In the final part of the book, he proposes solutions to restore equilibrium and balance in the three pillars.

In the first part, Rajan explains how the two pillars of society—markets and state—emerged from the community itself. The feudal community in medieval Europe encompassed both state and market. The feudal manor produced goods for self-consumption and there were no trade/market transactions. The functions of the state such as security and justice were delivered by the lord of the manor himself. Over time, with increase in trade with distant places, and with advances in military technologies and unification of territories, both the state and markets started growing, while the feudal community declined. Over a span of a few hundred years, constitutionally limited governments and free markets emerged in Europe. The feudal vassal was replaced by the commercial tenant, and parliamentary bodies dominated by propertied individuals served as a check on the powers of the state.

However, the commercialisation of agriculture had led to massive unemployment among the peasants who were forced to work in factories in the cities under terrible working conditions. As markets became dominant to the detriment of the community, the workers pushed for political representation. By the beginning of the twentieth century, male workers were eligible to vote in most countries of North America and Western Europe. The extension of suffrage re-empowered the communities. Workers also pushed the state to impose regulatory constraints on the market and provide public services like schooling and health care. Eventually liberal market democracies emerged across the developed world in the early twentieth century, with powers aptly distributed between the three pillars.

However, the onset of the Great Depression in 1929 changed the power structure between the three pillars. The enormous economic adversity caused by the prolonged slowdown turned public sentiment against markets. Market competition was blamed for the failure of small businesses and the private sector came under heavily regulated regime. Many industries were nationalised. The Great Depression, thus, marked the ascent of the state.

The developments after the Great Depression and the Second World War are analysed in the second part of the book. The Great Depression had created an anti-market sentiment and the state expanded at the cost of the markets, a trend which continued into the Second World War. The three decades after the Second World War saw spectacular growth as economies were rebuilt after the war and international trade resumed. The increased prosperity prompted governments to put in place social security benefits for the people. However, in the 1970s, growth slowed considerably. There were a number of reasons for this slowdown: increasing inflation in the United States due to spending on the Vietnam War; the breakdown of the Bretton Woods system; and the OPEC oil price shock. Also, most of the advanced economies had moved closer to the frontier of their production efficiencies, where growth is more difficult to generate. Meanwhile, the ICT revolution that started in the 1970s was changing the nature of jobs and creating inequality.

The US and continental Europe responded to the growth slowdown in different ways. While the US opted for deregulation, privatisation and trade liberalisation to give markets the upper hand, continental Europe looked more towards integrating markets to regenerate growth. Although growth picked up in the mid-1980s, it was insufficient for the government to deliver on the promises made earlier, and government debt kept increasing. The paths adopted by both the US and Europe had their own problems. In the US, while the liberalisation of markets initially brought about efficiency, market entities increasingly sought to restrict competition. Firms exploited the lax anti-trust regulation and resorted to ever-greening of intellectual property rights to preserve their monopoly power. The rise of the ‘superstar’ firms further exacerbated the inequalities created by the ICT revolution. Towards the beginning of this century, when it became clear that something had to be done for those left behind, the government sought to boost housing demand through cheap credit. The housing boom created a rosy picture. Housing construction generated the much-needed jobs. It also supported consumption growth, as existing homeowners took loans against the higher value of their homes. The debt-fuelled growth, however, proved unsustainable, leading to the global financial crisis of 2008.

In Europe, integration of goods, services, labour and capital markets took place through the formation of the European Union (EU). The free movement

of people within the Union, however, caused dissatisfaction between citizens of different nationalities, who were from different historical backgrounds and cultural sensibilities. In addition, the adoption of a common currency without adequate discipline on government spending led to very different levels of inflation between countries in the euro area. Even while inflation was different across countries, all had the same policy interest rate as they had a common central bank. Thus, borrowing appeared very cheap in the high inflation countries, which ultimately culminated in the European debt crisis.

Rajan argues that the source of much of the problems of today, like populist nationalism and radical leftist movements, lies in the imbalance between markets, state and communities. Communities have become too weak relative to markets and the state. The ICT revolution coupled with trade liberalisation and market integration has led to the loss of middle-income jobs for the moderately educated workers in the advanced countries, while increasing the wage premium for highly educated ones. The loss/unavailability of jobs for the middle class has taken a toll on their families leading to a deterioration in the living environment for children. This has resulted in poor school performance, drug addiction and crime, which has vitiated the community environment. As still functional families move to better neighbourhoods to escape the unhealthy environment, dysfunctional communities deteriorate further. They are left with worse community institutions and less social and economic capital to support their members. Thus, economic decline leads to social decline and they reinforce each other to form a vicious cycle. The alienated individuals in dysfunctional communities then fall prey to radical left and populist nationalist ideologies that blame the corrupt elite, minorities and immigrants for the problems at hand.

Before moving on to propose solutions to this problem, Rajan turns to China and India. In China, the state has dominated markets and communities, posing a variety of problems: overcapacity in industries due to excessive investment, over-dependence on exports and large government debt. In India, on the other hand, the state faces capacity constraint in creating infrastructure, providing essential public services, enforcing regulations and clearing court cases. Thus, China needs to build a constitutionally limited state while India needs to enhance state capacity.

In the concluding part of the book, Rajan proposes ‘inclusive localism’ to rebalance the three pillars. The author describes localism as ‘the process of

decentralising power to the local level so that people feel more empowered in their communities'. While empowerment of local communities will give them a sense of responsibility, markets will create competition to ensure that society remains efficient, and the state will ensure that communities do not become insular by enforcing free movement of goods and people.

Rajan argues that empowering communities would ensure that the members are well placed to adjust and absorb shocks from rapid technical changes, which require workers to develop new capabilities to participate in the job markets. Workers may also need financial support in case of economic downturns. Rajan argues that to remain relevant in times of rapid technological changes, what is needed is a solid foundation through quality school education, rather than higher education for everyone. A robust foundation would promote lifelong learning so that workers have the flexibility to move between industries as the economic environment changes. Communities are instrumental here. Research studies have found that the home environment and the socio-economic diversity of students in schools contribute significantly to learning outcomes. In this respect, communities can support learning by providing an enabling atmosphere that encourages student motivation, discipline and safety. With regard to support in times of economic distress, Rajan is of the view that the formal safety net provided by the state should be at a basic level, and that communities can supplement this, based on the needs of their members. In this way communities could provide additional buffers against market volatility.

This book has lucidly portrayed the big picture of the economy through the interplay between the three pillars of state, markets and community. A major contribution of the book lies in moving beyond the realm of traditional economics—markets and the state—by highlighting the important role of the community. Beginning with a historical perspective about the evolution of the three pillars, it elaborates upon the changing dynamics between the 'pillars' over time as significant shocks like the Great Depression and the ICT revolution hit the economy. Analysing the present situation through the lens of the three pillars, it concludes that strengthening the community is necessary to bring about balance in society. The arguments in the book are illustrated with real world examples, data and research studies, which not only lend support to the author's ideas but also make the book a delightful read. The book is engaging and thought-provoking. However, while the book offers

broad solutions to rebalance the ‘pillars’, the devil may lie in the details. The solutions offered seem difficult to implement at times. For example, Rajan writes that when it is not possible to revive a dysfunctional community, it is better to let it die by facilitating out-migration. He writes: ‘...countries and communities should explore the possibility of subsidising moves by the unemployed from high-unemployment communities to elsewhere in search of employment’. The practical feasibility of such measures is questionable. Also, devolution of powers to local levels requires immense political will. As we have seen in the case of India, the process of constitutional decentralisation to create the third tier of government was a long-drawn affair. Even today, the degree to which this devolution has been successful remains a topic of debate. However, as Rajan himself acknowledges in the preface to the book, the policy prescriptions he offers are not the final word, rather they are intended to provoke debate and inspire action. In this sense, Rajan has achieved his objective, but it remains to be seen how many stakeholders draw inspiration to translate new ideas into policy actions.

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