International Seminar (Under UGC-SAP-DRS 1) on State, Market and Democracy in India, organised by the Department of Political Science Jamia Millia Islamia, New Delhi on 27-28th February, 2019

Presentation by Pradeep S Mehta, Secretary General, CUTS International on

State, Market and Democracy

The topic for my reflection today is State, Market and Democracy. **I will speak on it in a broad sense to be eminently intelligible and provocative.**

Why are we talking about them is an important question? India was not meant to be a market democracy, if the constitutional spirit is anything to go by. 29 years after the independence i.e. in 1976 we felt the need to formally include 'socialism' as an explicit reminder in the preamble to our constitution but only 14 years later i.e. in 1991 we felt the need to change our practice away from that goal and bring about market liberalisation, and now 28 years hence the world throws at us two grand failures – Failure of Socialism and Failure of Capitalism.

A part of the reason of these failures can be attributed to how the state responded to both these principles of running and managing the economy not just in India but across the globe. And to make things more complex, the Chinese growth model serves as a rude shock to the idea of democracy around the world – speaking strictly in the economic sense.

In short, what we have learnt is that relationship between markets and democracies have to be crafted carefully rather than assuming that the latter will automatically facilitate the former. This thought, once considered truism, is now under severe scrutiny. Therefore, the role of the state assumes not only unprecedented significance but also calls for radical overhaul in its capacity to analyse and act.

This is particularly important in light of the following facts:

First, the fundamentals of 'industrialism' are being challenged world over. These fundamentals are premised upon the relationship between factors of production i.e. land, labour, technology and capital. In the new economy facilitated by unprecedented technological intervention, **this relationship is increasingly being redefined and the search to disrupt drivers of economic inequality is pre-occupying policy discourse globally.** In other words, the new economy is rendering some of these factors increasingly redundant in the quest for higher productivity.

It is therefore not surprising that questions about the fundamental structures of economies are gaining traction. India too is no exception. With a burgeoning labour force coupled with challenges of jobless growth, equity and sustainability, these questions are all too important for India also.

Second, many of the imperatives for growth and development of India like better health, quality education, affordable and reliable electricity, productive and remunerative agriculture, digital and physical connectivity, sustainable urbanisation, ease of doing business and non-vulnerable employment cannot be addressed without the proactive role of subnational entities.

Further, with many a disruptions catalysed by rapid technological change, traditional business models which catered to provisioning of basic necessities are also going through a rapid reset. For instance, large scale utilities have started to focus on decentralised models while 'individual focus' is gaining supremacy as technology is increasingly facilitating fulfilment of unique demands in almost all spheres of life.

In other words, what we are seeing is a trend towards hyper decentralisation.

Third - the new data economy is bound to challenge the most basic of all things i.e. Freedom. All democracies, regulations and markets around the world are modelled around this concept.

The other word for freedom is individual choice but with so much of data being collected and processed by big tech corporations which have become larger than nation states in many ways, the fear is that the individual choice could well be shaped and determined by big tech corporations rather than people. **Therefore, if the idea of 'people' is challenged, the idea of democracy too stands challenged**.

The combination of these three challenges is perhaps the biggest challenge being faced by us today but ironically the state is still cast in the old mould and hence slow to react to these challenges.

An evidence of this fact is that we have not yet accorded the due importance to many of these issues. Conversations on inequality, however, have just started to gain traction.

For instance, new ideas like **Universal Basic Income or Universal Basic Capital** are being discussed as new redistribution mechanisms but at best they seem to be avoiding some fundamental questions.

The proponents of these propositions are caught in the merits, demerits and design aspects of these solutions without realising that re-distribution strategies have miserably failed in the past. **More importantly, focus on these**

aspects blurs a more important background i.e. why in the first place are we talking about them?

Therefore, fundamental fault lines in the economy need to be understood. They need to be understood to understand that misallocation in any factor market conditions can lead to misallocations across the chain. In a globalised and hyper connected world, such misallocations would be difficult to rein in within any particular geography. For instance, if capital is allowed to make unlimited amount of capital, the end result would be the death of capital itself as other capacities and capabilities would remain stalled. In such a scenario, the means to create new capital would eventually diminish.

Therefore, temptations to continue with business as usual must be resisted. In other words, there is no point in aping the growth models practiced by the developed economies. One must understand that it is exactly those growth models that have gotten us into this logjam.

To put it differently, every time a system fails, stimulus of 'cheap' (low interest rates) capital is infused. With money coming in cheap, misallocation is easy and the result is excess of capital and excess of labour. The other side of this problem is stranded capacities and high NPAs – something that we have been experiencing in India.

To substantiate what happened in India, one has to just see the investment binge between 2003 and 2012. Nothing short of a bubble this binge was fuelled by excess global liquidity and easy bank credit. The result is that India Inc added massive capacities in mining, metals and power generation based on over-optimistic domestic estimates and Chinese demand. But with the global commodity super-cycle popping and the domestic downturn hitting demand, the excesses of that period have cost the economy dear.

To date, Indian banks are still grappling with NPAs while most of India's big industrial houses are soaked in debt distress.[1]

So how do we move forward?

I wish I had solutions but I am afraid I don't. What I indeed have is to offer a different perspective to look at the relationship between state, markets and democracy. In doing so, I will borrow some thoughts from Roger Martin's[2] recent piece *The High Price of Efficiency*, published recently in the Harvard Business Review.

The gist of the arguments made in that piece suggests that **instead of market efficiency the focus should be on market resilience**. This is because rewards from the efficiency get more and more unequal as the efficiency improves. This leads to ever growing market power to the most efficient competitors. The end result is the Pareto distribution of wealth i.e. a highly skewed and unequal distribution of surpluses generated in the economic activity.

In other words, super-efficient dominant model elevates the risk of catastrophic failure which is most dangerous in the areas of new economy where competitive advantage is often tied to network effects, which gives incumbents a powerful boost.

The solutions therefore, as argued by Martin, must entail polices that limit scale, policies that introduce some friction in the path to efficiency, policies that promote patient capital, policies that create good and better jobs and teaching for resilience.

These prescriptions have eminent merit and are not de-linked from each other. In fact, they are possible only in combination with each other.

---

[1] https://www.thehindubusinessline.com/opinion/editorial/cautious-on-capex/article25994438.ece
[2] Director, Martin Prosperity Institute, University of Toronto, Rotman School of Management

For instance, if competition policies can rein in market domination of a kind that crowds out any competition whatsoever, then a lot many enterprises can be created which can ensure a distributed spread of capital. For the growth of these enterprises, some kind of legitimate trade barriers would be acceptable. Such incentives can be given in lieu of promoting long term capital as its value would be greater than short term capital. In other words, it can lead to creation of companies with long term strategies. Such companies are then most likely to invest in human capital for long term productivity. In other words, they will care for workers who are also consumers of their products and have the capacity to buy them. In a nutshell, they will realise that cheap labour is actually more expensive, and last but not the least teaching for such ethics, which Martin describes as 'Resilience', should start at management schools which are currently over obsessed with 'efficiency' as the ultimate goal.

It is interesting to note that Martin is not alone in this thought. His basic argument resonates with the view put forth by Joseph Schumpeter, regarded as one of the greatest economists of the first half of 20th century who opined that dynamic capitalism was executed to fail because the very efficiency of capitalistic enterprise would lead to monopolistic structures and the disappearance of the entrepreneur.

Therefore, as a solution he emphasised the importance of 'innovation' but one that is a process of industrial mutation, that incessantly revolutionises the economic structure from within, incessantly destroying the old one and incessantly creating a new one.

Is it not exactly what we are looking for to solve the puzzle that we are trapped in currently?

The State, the Market and the Democracy should come together for this 'creative destruction' to save each other from themselves!!!