

Interview with Dr. Raghuram Rajan, Katherine Dusak Miller Distinguished Service Professor of Finance at the University of Chicago's Booth School

# The Role of Community in Globalization – a Talk with the Author of *The Third Pillar*

By Japan SPOTLIGHT

One of the most distinguished economists in the world today, Dr. Raghuram Rajan, former Governor of the Reserve Bank of India, talks about his book *The Third Pillar: How Markets and the State Leave the Community Behind* (Penguin Books, 2019).

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## Motivation for Writing the Book

**JS:** Could you please explain what political and economic developments inspired you to write your book *The Third Pillar*?

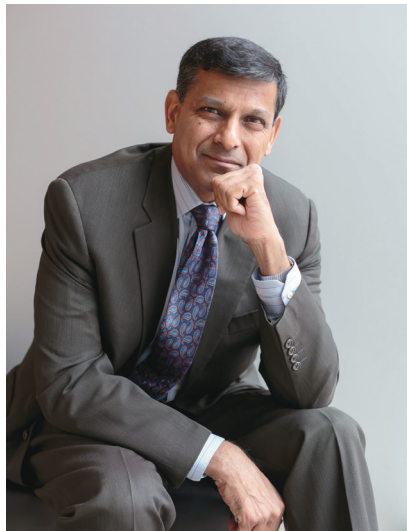
**Rajan:** I think the most immediate reason for the book was the sense that there was a lot of political fracture emerging in countries. Often, dominant groups seemed to be sensing their own vulnerability and often this was because they were not doing economically well. Even though others were perhaps doing worse, they were looking into themselves and finding that relative to the past they were falling behind. I was trying to say that this is something that has happened over time and to different groups. In the United States and Europe it was finally hitting the rural white male or the semi-urban white male, and had big sociological effects and political effects. You could explain some of the anxiety that people had as a result. I'm not saying this is the only thing that has emerged, but it was one of the factors that made me think more about failing communities and why they became a source of political risk as well as something that needed to be addressed if we are to have a better future.

## What Is "Community"?

**JS:** In your book you also stress the role of community in order to restore global capitalism and democracy. How exactly do you define community?

**Rajan:** Through much of the book I focus on the local community – that means the physical and proximate community. That doesn't mean that the virtual community does not matter at all, and as you

Photo: John Zich



Dr. Raghuram Rajan

know, one of the useful things contributed by social media and the Internet is that people can find virtual communities of their own, sometimes the continuation of a past physical community. My children keep in touch with their college mates a lot more than we have partly because they can form those groups on social media and continue that link. In many situations, especially the semi-urban one, the local community defines so many things including your ability to govern yourself, the powers that the local groups have, and the kind of facilities and institutions the locals have, as well as the nature of their daily lives.

In many communities, especially those that do not have much economic activity, you see a process of depopulation. The most capable people leave first, leaving behind the elderly and the ones who cannot move, who do not have the capabilities to move. It's these kinds of communities – both when they're doing well and also when they are doing badly – that become important to life for a large number of people in a country. Clearly, the same notion of physical community applies less in a metropolis when you don't know your neighbor, but I think this is a problem with modern life. The fact that in many high-rise apartments you don't know your neighbor really makes you lose something. Yes, you can still be in touch with your brother 8,000 miles away but if you don't enjoy the friendship of your neighbor, I think there is something missing.

## Decline of Community

**JS:** This kind of community is now in decline. Has it contributed to current crises such as rising nationalism and protectionism?

**Rajan:** Part of the explanation is the vicious circle that occurs when economic activity disappears from an area. As the economic activity

disappears, families start breaking apart because of the added stress due to the lack of economic activity, and there are more social ills such as teenage pregnancies, drug abuse, etc. Of course, this differs from culture to culture, and it is not universal, but the pressure of economic decline then turns to social decline. Then the social decline feeds into the decline of local institutions – the schools deteriorate in quality. You can have the “flight of the fittest” so to speak – they leave the community even less effective. This traps people, as the people left behind lack the ability to participate in a wider economy or to benefit from the wider economic growth. They become separate islands of underdevelopment in a very developed country. That becomes very hard to surmount; how do you cross the space separating you from the economy?

This is why we have to work on ensuring that groups are not left behind entirely, and that starts with trying to ensure that local institutions don’t deteriorate. To make that happen you have to ensure that local economic opportunities don’t disappear. It is about trying to prevent downward movement by ensuring that there is a spread of economic activity. Upward movement is harder, and involves a mix of strengthening local institutions, strengthening economic activity, and making people want to live there who have the energy and passion and willingness to move the community up. All those are difficult. In the book I argue that it is very similar to the problem of underdevelopment – how do you make an underdeveloped country developed? How do you make an undeveloped community become more developed once again? It requires a whole raft of things to come together. It’s not impossible – I think it is easier for an undeveloped community in a rich country to develop than an undeveloped country in a rich world to develop. The problem is a little easier as there are resources in the rich country and once you connect to the broader country there are lots of ways in which you can do well. However, it is not a simple task and if we are to do better, we need to focus on these issues in many rich countries.

**JS: In your book you also describe the history of the decline of the community. The IT revolution and globalization could be the causes behind this decline. How do you assess such factors behind this long history of decline in communities?**

**Rajan:** One of the themes in the book is how the expansion of the market continuously hits the community. The market is about getting the best opportunity at every point in time – what is the best and most advantageous trade? – while the community is about giving up

the best and most advantageous trade to do what benefits the community and the other person more than myself. Implicit in this are norms of reciprocity, norms of community value and community pride which substitute for the monetary benefit that I get when I do a market transaction. I help you because you are my neighbor, because you are part of the same community and I want the community to remain strong. So there is a lot of voluntary effort, a lot of support that we give each other which is based on different rationales and incentives than the market.

The problem is that the better and more specialized the market and the services that it offers, the more it tends to substitute for the community. Would I want to use my neighbor as a babysitter when there is a professional babysitter around? Maybe I don’t want to trouble my neighbor. Would I want to go to a hospital rather than use my neighbor as a midwife when I am having a baby? I would go to the hospital. So the modern global economy intrudes on many of these community functions, which then adds pressure on it to break down.

It’s not an entirely one-way street and it is possible for people to say, yes, we understand that there are all these ways that the market intrudes, but therefore it is incumbent on us to do more to get that sense of community. We should have more block parties, we should see each other more, we should make it an obligation to go and coach our children at soccer for example so that we can all meet together. We should have a community garden. We have to find new ways of bringing people together when the general trend is to move people apart. This is where technology has a two-way flow. On the one hand we say that the Internet occupies people, and that technology distracts people from physical action – but you could have said this of the radio, of the TV. Now people are saying the same about social media, but this also allows people to keep in touch so it really depends on how the technology is used – it can be for good or bad.

Another theme in the book is that because markets have grown, governance keeps getting elevated to higher and higher levels – we are taking away powers from the community and putting them at the national level, we are taking away powers from the national level and putting them at the international level. What I am arguing is that too can be changed. We should follow the principle of subsidiarity and not locate a power at a higher level than the lowest level at which it can be exercised. That can give people a sense of why they should come together – in order to do things because the community is empowered. If a community wants to build a community center or community garden for example, then people would come together. They can vote on it or start building it, not for the purposes of getting

rich from corruption but because they can do something together. In this globalized world, given that the forces of globalization continuously attack the community, you have to do more to preserve the strength of the community and that means pushing more powers than the past down to the community.

Put differently, there is value to international trade, and I am for international trade and migration, but I also think that as those borders come down, small borders around the community that give the community a sense of belonging can be useful. These don't need to keep others out – which is why I call it “inclusive localism” – but it gives people a sense of identity. We are an open community but there is a definite identity and set of values that we think people should have if they want to join us. That is how a modern community can start emerging, even in the face of social media, globalization and in the face of too many powers being elevated.

**JS: It might be a good idea to decentralize government administration. Should local governments be given greater powers over the local community?**

**Rajan:** For some things. As soon as you use the word decentralization and more local power, people will immediately say two things: first, that people at the local level are far less competent than the national level, and secondly, that there will be a lot of corruption and local elite groups gaining strength. To the first one, I would argue that it is possible that in a national search I will find better people than in a local search. But the value of having local functionaries is that they know the area, the people, the problems – and so to that extent there is more local knowledge and local solutions. Bringing in outside expertise is not ruled out, but if the decisions are being taken by the locals, they tend to be more suitable to what the local needs are – informed by best practices elsewhere. Ideally, you want the community to benefit from experiments elsewhere, from learning what others have done, and there are ways of bringing community's leadership together. It is never clear to me that corruption locally is less or more than national corruption.

But I think you can have two sources of monitoring of local authorities: one is on top, light monitoring from the national level to make sure that monies do not end up in a Swiss bank account. Then local monitoring is from people who know how much money was sent to build a bridge for example, that sort of bottom-up monitoring that asks what was done, who are the contractors, etc. There are three “fs”: funds, functions and functionaries. You have to have funds – you have to have power, that is the functions, and you have

to have the local functionaries that are going to do the work. But you put all three together, and there is no reason why you can't have local monitoring of those people and top-down monitoring also. So I don't think corruption is inevitable and I think it is possible in this more transparent world with social media to get better engagement as well as monitoring.

## **Balance Between State, Market & Community**

**JS: In your book, you call for a balance between state, market and community. To strike this balance, what is most pressing?**

**Rajan:** At this point, I would say following the principle of subsidiarity is the first task. To have more functions pushed down to the local community. Second is to enable those communities to have the funds to carry out some of the necessary actions to improve. Some communities have plenty of funds and some have too little, so there needs to be a balancing out of funds without removing the powers of the local community. What happens sometimes is that funds are given, but there are rules that come with them which take away autonomy from the local community. Give the local community more functions but allow them more funds. In a sense, facilitate the engagement of the local people – make it a more democratic process by which ideas and policies emerge locally. In that way you strengthen democracy, you strengthen empowerment, and you make people a little more willing to accept change because they have some control over how they react to the change through the functions and funds that they have. That sort of leveling up is needed and I would start with the functions but would add the funding.

Where do the functionaries come from? Where do the community leaders come from? It's a mix of people already in the community growing into leadership. Many people can grow into these leadership positions, and this is one important aspect. The other is to try and attract people into the community from outside, people who have left but have a natural affiliation with that community. Modern technology and distance working has made it possible to get people to come back to the community to work there because they can do their work at a distance and then maybe go to the big city once in a while to work there. The silver lining in the pandemic is that you can get work to be better distributed. That in my mind is a very big positive because it allows a stronger group of individuals to work with the community, individuals who are bringing back expertise from outside and who can fertilize the community in a different way.

## JS: How do we nurture such leaders?

**Rajan:** Some of it will emerge naturally: if you create more attractive positions which have the funds to make a difference, people will see the value in the job itself. There is no point in being a mayor without any functions but if you have some funds to carry things out, people will see the job as an attractive position as it allows them to make a difference while also being a stepping stone to higher office. President Barack Obama was a community organizer. People are attracted to those kinds of positions once they know they can have some effect.

There are also policies that can allow more people to go back; for example, if you have differential taxation based on residence, if you go back to an undeveloped community and establish residence there could you get some benefit in terms of taxation? You could also think about forgiving student loans, for which there is a big movement in the US. Perhaps student loans could be more easily forgiven for people doing jobs with more of a social or community nature. There are lots of ways to incentivize people to go back, but the biggest change is working from home as a result of the pandemic. This will make a huge difference in your ability to get good people to stay at a distance from the city because now they can enjoy the benefits of the kind of work they were used to in the city but at the same time live in a nice area.

## Immigrants & Community

**JS: On the question of immigration, it will be increasingly important to integrate immigrants into the community and perhaps this would also be relevant to tackling the challenges of the aging of society and depopulation that will be faced by many developed nations in future. What kind of policy would be necessary to realize good integration of immigrants into the community?**

**Rajan:** It's a complicated question, because what does integration mean? Do you want them all to look the same, wear the same clothes, eat the same way? If you want it all in that direction then you may lose some of the vibrancy that they might bring, and you may make it less attractive to the best immigrants because they will have to lose their whole cultural identity to immigrate to that country. On the flipside, you don't want them to be entirely in a ghetto of their own as if they have just transported their home country into the new country, and make no adjustments to the values and culture of the

new country. It's somewhere in between and I think that the more voluntary integration is the better. How do we force over time through various incentive structures integration on the elements that we think are important? This person should believe in some of the values of the country that they choose to live in but without losing some of the aspects that make them interesting. How do we do both? Countries will have to figure that out and the sooner they start, the more chances they have of integrating in a way that they find reasonable. If you do it when you are desperate for new labor, then it becomes harder to integrate those communities that you are drawing in because you are drawing them in for their economic value only.

**JS: Turning to Japan, how could this racially homogenous country manage to integrate immigrants into their community, assuming that accepting more immigrants into Japan would be a more relevant policy for Japan as opposed to using robots or AI.**

**Rajan:** This is a very important question which also applies to China, another very homogenous country. Again, there are the usual concerns – how do we ensure that our culture doesn't get lost? At the same time, how do we ensure that we stay in a relatively young society? There is no point in having a culture if we continuously shrink as a society and become less important and visible in the global scheme of things. Japan as an idea is more important than the physical land that Japan occupies, and its cultural footprint and imprint and so on. There is a famous saying in Lampedusa: "The more things have to stay the same, the more things have to change." In order to preserve the culture, do you have to make changes at the margin? And what kinds of changes should one make?

In this day and age, it's very hard to get a set of people to agree to a second-class citizenship in a country. The Gulf countries have a much bigger problem because there the size of the citizen population is much smaller than the immigrant population but they have tried to keep the immigrants as non-citizens but are finding it increasingly hard to do that. I would say that in any country in the world, if you want to attract high-quality immigrants you have to be prepared to offer them equal status. But how do you do that in a way that is consistent with maintaining your culture? You start small, you focus on integration as best as possible, and things evolve. Almost surely there will be change on both sides. The immigrant will become more Japanese, Japan will become enriched by a variety of immigrant cultures, but if done well there does not need to be a sense of being swamped. Cultures change – technology changes cultures and so

immigration will also change them but can it be done without causing anxiety that people will lose their identity. I think it can be done, but you have to respect both sides.

## **Restoration of Community & Rules-Based International Regimes**

**JS:** In terms of recent economic developments, the US-China cold war could destroy global supply chains causing enormous economic demerits. In order to save the global economy from this, some kind of rules-based global governance – such as the WTO or FTAs – would be necessary to restore the trade and investment regimes based on liberal ideas. So could your notion of restoration of community be helpful in building up such rules-based international regimes because anti-globalization could be mitigated by restoration of the community?

**Rajan:** To some extent, we need to keep the rules at the international level light, but bring in all the countries to think about what kind of regime they would feel comfortable with. Certainly from the Chinese perspective, they will question who made these international rules in the first place. So I think we need to think about situations with the most friction and conflict and try to renegotiate the rules to bind countries but at the same time give them a sense of participation in framing those rules. There are some standard examples – why is the head of the IMF always a European? Why is the head of the World Bank always an American? These are postwar anachronisms but reflect the mentality of those institutions.

Obviously over time there is change but it is a very slow change. The question we have to ask is what does a new world order look like? There are some rules needed at the international level, for example right now there is a question of what would a central bank digital currency look like across borders and how should it be created in such a way as not to cause disruptions to other countries? Those are things that we need to discuss, as well as climate change and how we deal with it. Yes, there will be some leadership by the G7 and US, but now we should engage in discussion on the basis of a more multipolar rather than unipolar world. If we engage in the right spirit we will get better outcomes, but my fear is that we won't because the old powers will try to protect the status quo, the new powers will reject that status quo, and there will not be a meeting of minds. Then nobody is constrained and we get more conflict and we

have to try and avoid that.

## **Inclusive Growth & Community**

**JS:** People are advocating an inclusive and egalitarian economic system as necessary for restoring capitalism so your idea of community could be restored well by such an economic system. Would you concur with this idea?

**Rajan:** What I like about capitalism is the level playing field and competition because that produces efficiency. What I think we don't have is the level playing field and as a result we don't have appropriate competition. I am referring to what happens before we enter the market, and I am fearful that we become very unequal because we have different parents, different communities, and we grow up in different environments. By the time we get ready to compete we are different people because we have had very different benefits. By emphasizing the community, what I am trying to say is that we need to equalize the way we enter the market so we become more naturally competitive, but also ensure that capitalism is not seen as unfair.

Some have better luck and succeed more than others, but they are not discriminated against right from the beginning. The problem today is that we are discriminated against right from the day we are born due to the fact that family, community, wealth and so on determine who we are. Now that we are so rich, it would be great to see how capitalism can equalize those circumstances a lot better. Inclusive and egalitarian is the way into adulthood. Early childhood, schooling and early college – after that you should be allowed to compete. There should be a safety net but capitalism is about competition, that's its strength. It's not who you know but what you can do that makes you succeed. And that is what we should allow for while ensuring that people have enough capabilities when they enter the capitalist system.

**JS**

Written with the cooperation of Joel Challender who is a translator, interpreter, researcher and writer specializing in Japanese disaster preparedness.