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Renewed govt purpose

The UPA can congratulate itself on its victory in Parliament on Tuesday, when the government's trust motion was carried with a comfortable majority. The victory may have been marred by allegations of cash pay-offs to buy MPs' votes, allegations that have been lent some currency by the extent of cross-voting done by members of the various opposition parties. But, undeterred, the stock market has celebrated with a surge in prices, signalling the widespread expectations that the Prime Minister will be able to deliver on his promise of faster reforms. The executive decisions on disinvestment and other such issues can be taken without delay, but the passing of Bills that need approval by Parliament will have to wait a little longer perhaps, till the winter session. It remains to be seen whether the government encounters fresh problems then in mustering a majority, or whether the proposed legislation will go through. In any case, the immediate and pressing issue does not confirm long-range reforms that will benefit the country for months and years down the road; for, the government has to deal with inflation and with the damage being done to the fisc by price controls on petroleum products and fertiliser. If India runs up large twin deficits (fiscal and trade), it could destabilise the economy well before the elections, which are due next year. It is imperative that the government bring the situation under control without further delay.

Meanwhile, it is the Opposition parties that are convulsed by crisis. The BJP is busy expelling its parliamentarians who flouted the party whip, and must ask itself whether it was correct in taking the position it did on the nuclear agreement. Its strategy of not toppling the government but giving it a bloody nose on the morality issue has worked. But few will argue that the party has much to show by way of political gains — especially since various accounts of parleys between the government and the BJP say that the party's leaders had indeed approved of the deal, before backing out later. Also, the party's lacklustre showing during the debate on the trust motion raises questions about how effectively the party is being led in an election year.

As for the CPI(M), it has gone to the extraordinary extent of expelling from its ranks the Speaker, Somnath Chatterjee. Indeed, the biggest loser of them all is Prakash Karat, who has driven his party and its Left allies into a hopeless corner, with company that it does not care to keep. He and his party have lost their leverage on the government, they will no longer be able to fill the air-waves on sundry policy issues, and they face the prospect of finding their parliamentary strength significantly reduced when the Lok Sabha elections are held, for they are expected to lose ground in their stronghold states of West Bengal and Kerala. If leadership is to be judged by the end results, then Mr Karat's must be questioned.

As for the issue that sparked the political face-off, India is now free to go ahead with the civilian nuclear agreement with the United States. The approval of the board of the International Atomic Energy Agency should be a shoo-in when it discusses the India-specific safeguards agreement next week. However, it must be presumed that a good deal of diplomatic footwork will be required to see the deal through the Nuclear Suppliers Group and the US Congress, especially within the tight schedule that now exists.

Another try

Intense negotiations seem to be on the cards in the World Trade Organisation (WTO) "mini-ministerial" meeting on the Doha Round of trade talks, now under way in Geneva, but the chances of hammering out a deal appear slim. The informal discussions between trade ministers of some key WTO member-

agriculture and agro-based exports, especially those of fruits, vegetables, dairy products, sugar and the like, are not undermined. It is also in India's interest that its flourishing services sector gets enhanced market opening in the developed countries, something that the US and others are unwilling to concede.

Illustration by BINAY SINHA

Towards stakeholder capitalism?

India can take the path Anglo-American capitalism has taken over the last 200 years, says DEEPAK LAL

In my last column I had examined the travails of Anglo-American managerial capitalism, arguing that it was the success of incumbent managers (the insiders) in using the political process to limit hostile takeovers (by outsiders) which has led to excessive executive compensation at the expense of the shareholder owners of corporations. In the process income distribution also worsened. An important feature of this form of capitalism, providing economic opportunities even for those without their own resources, and enabling outsiders to challenge insiders to impart the dynamism of creative destruction which is involved in the most efficient deployment of an economy's resources, was also attenuated. The US search funds which allow those without collateral or connections to finance their new ideas, is emblematic of the Anglo-American capitalist model.

But since the late 19th century it has faced competition from the corporatist "stakeholder" model pioneered by Germany after its unification in 1871, and adopted by the reformers of the Meiji revolution in Japan. The major differences with the Anglo-American variety were, first, the toleration of cartels, as (following Fredric List) the nation rather than individuals was considered the basic economic unit, with industry required to serve the national weal. Second, there were incestuous relations between the industrial corporations and commercial banks. Third, German corporations had a two-level system of corporate control: a management board for day-to-day management and a supervisory board consisting of various stakeholders: shareholders, banks, cartel members, local politicians and trade unions. Fourth, companies had to provide social insurance to their employees as well as "co-determination", by giving them a formal voice on company boards.

The Japanese chose a variant of this stakeholder capitalism through the *zaibatsu*. These were conglomerates, which included banks and insurance companies, at whose centre was a family-owned holding company, with other associated firms linked by cross-shareholdings and interlocking directorships.

After the war, the US tried to introduce more features of Anglo-American capitalism in the two countries. But both reverted to their older corporatist forms. The German "social market" recreated Bismarckian corporatism, while Japan saw the *zaibatsu* reborn as the *keiretsu*. This model was exported to other Asian countries, most notably South Korea, whose *chaebol* was another form of corporatist capitalism. This is the so-called Asian model of capitalism.

It was successful as the countries adopting it were latecomers to industrialisation, catching up with the industrial leaders in the UK and the US. Late developers with abundant labour can easily discern the initial industrial structure in line with their comparative advantage. It will consist of small-scale labour intensive industries, which can be financed through the extended family or small partnerships, run by owner-managers. With growth and the shift of comparative advantage to progressively more capital-intensive industries, families would not have the large amounts of capital required to establish such businesses and retain control, avoiding the "agency" problems of managerial capitalism, discussed in my last column. This problem can be overcome by creating large concentrations of wealth or finding ways for some concentrated wealth holders — like rich families — to indirectly control enterprises run by managers. The Indian managing agency system is an example of the latter path. It has resurfaced in a slightly altered from since the 1991 economic reforms.

In the countries of stakeholder capitalism, the financial institutions of the family-owned conglomerates channelled the savings of the general public to their enterprises. This process was directed by the State as a major stakeholder, creating immense moral hazard. Neither the controlling family members, whose financial stake was diluted over time, nor the managers or bankers found it necessary to undertake prudent investments. After the easy "catch-up" stage of capitalist development, many bad investments were made leading to financial crises.

Thus in Japan, Aldo Ando ("On the Japanese Economy and the Japanese National Accounts" *NBER* wp. 8033, 2000) has calculated that, from 1970 to 1990, because of these bad investments the Japanese corporate sector incurred capital losses of $405 trillion, with non-financial corporations earning a rate of return of about 2.5 per cent and financial ones 1.6 per cent. Japanese households, having cumulatively saved $1,250 trillion (at 1990 prices), found they had suffered a real capital loss of $389 trillion. Thus an ageing population found that its stakeholder capitalism lost 31 per cent of its lifetime savings over 30 years. No wonder the aged Mrs Watanabe continues to save rather than spend to see her through an uncertain old age. A generation which propelled the Japanese miracle, after war-time destruction, finds its hopes along its savings turning to ashes.

What then explains the undoubted economic success of the countries adopting corporatist, stakeholder capitalism? A neglected study of the comparative growth experience of OECD countries by Maurice Scott (*A New View of Growth*, Oxford, 1989) shows that the Japanese growth rate of 9 per cent between 1960 and 1973 and the German rate of 6 per cent between 1955 and 1962, can be explained entirely by the investment rate, the growth of the quality adjusted labour force, and a catch-up variable. The stakeholder model of capitalism had little to do with it. But their subsequent decline in growth and their continuing economic stagnation is due to the rigidities and inefficiencies in their labour and capital markets caused by the stakeholder model. Reluctantly, along with other adherents of the "Asian model", they are moving towards the shareholder model of the Anglo-Americans.

India has combined "owner-managers" in its large business houses, with its legacy of the institutions of Anglo-American capitalism. But the post-Independence financial repression with the banks being nationalised prevented the free entry into the capital market, which is the hallmark of Anglo-American capitalism. Today, by allowing takeovers, completing the privatisation of banks, and ignoring the proponents of stake-holder capitalism, India can repeat the dynamic capitalist growth which has been a hallmark of the Anglo-American capitalism over the last 200 years.