

NOTE

## The Percolation Theory

**Bharat Jhunjunwala writes :**

In an interview with TV18 in January Finance Minister P Chidambaram said “Economic reforms will work for those who are at the top of the pyramid first and then will percolate down to the middle as well as the bottom levels.” Accordingly the main task before the government is to make the country prosperous. Distribution will happen slowly on its own. This prosperity will come by proper allocation of resources, which is achieved through free run of the market. Say call centers are able to pay higher price for electricity because they are making huge profits. The slum dwellers can pay less because their contribution to economic growth is less. The market will provide more electricity to the call centers and lead to higher rate of growth. The benefits of the call centers will percolate to the slum dwellers in due course. The government should not interfere with the market so that resources are allocated to those that produce more wealth. It is seen that poor villagers settle in the slums of Delhi, Kolkata and Mumbai and enjoy facilities such as tube light, refrigerators and TVs. The government should let such percolation happen on its own.

Percolation of income may be a mere trickle. The rich can use capital-intensive equipments and reduce the demand for the services provided by the poor. The call center, for example, can use vacuum cleaners and automatic tea-making machines leading to less demand for janitors and street-corner tea suppliers.

Free run of the market leads to equal encouragement to the consumption of ‘good’ and ‘bad’ items. Healthy products like Chyavanprash and harmful products like cigarettes are treated equally. The market does not provide any mechanism to educate the people about the health- or welfare impact of the goods consumed. The welfare of the people can be reduced by uninformed consumption of bad products.

Advertisements can be used to spin the minds of the people and get them to consume harmful products like X-rated movies and bottled soft drinks. There is some evidence that health of Indian Children is declining as growth rate is increasing.

The market has no mechanism to deal with mental anguish arising from increasing inequality. A village lad may be happy in an urban slum with his TV but he can yet be much agitated seeing the rich pass by in their air-conditioned cars. This leads to more violence along with economic prosperity. For these reasons allowing the market to determine the allocation of resources as suggested by the Finance Minister is not acceptable. On the flip side the results of government-led welfare schemes have not been satisfactory either. Soviet Russia built huge welfare machinery but it collapsed under the weight of luxury and waste perpetrated by the Communist Party officials. Indira Gandhi implemented *Garibi Hatao* plan the beneficiary of which was the government welfare mafia rather than the poor.

This year’s winner of Nobel Prize in economics Prof Edmund Phelps has suggested that the European governments provide subsidy to employment instead of running huge money-guzzling welfare schemes. Such differential rates of taxes will benefit those telephone companies that lay cables by manual labour and hurt those that do the same by excavators. Companies will compete with each other to employ more workers so that they can avail of tax concessions. Present law requires that manufacturing companies undertake an energy audit of their operations. A similar ‘employment audit’ can be required by manufacturing and service companies. The government can impose a ‘High Capital-Labour Ratio Tax’. Companies that employ more capital and less labour may be subjected to a higher rate of tax.

Economic reforms should be applied to welfare sector. Nitish Kumar Government in Bihar has decided to implement the *Antyodaya* scheme through vouchers that can be encashed by the beneficiary at a shop of his choice. The same formula should be applied to central schemes like Integrated Child Development, Rozgar Guarantee and Indira Awas. Beneficiaries can be provided coupons that can be encashed for the specified service at designated locations. This will create competition among the welfare providers and help dismantle the government welfare mafia that is making merry by locking the poor into poverty. ~~///~~