

## Political Economy of Reforms in China and India: A Short Commentary

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Both China and India have been open to a continuing process of economic reforms over the last few decades. In China the pace quickened in the pro-reform regime which started with the leadership of Deng Xiaoping in 1978. The changes, while restraining state authority, especially on farm production, did, however retain the supreme authority of the Chinese communist party over decisions at level of the central and local governments. These involved the institution of the National Peoples' Congress which operates as the final approving authority behind most changes in policies. Close links between the sole ruling party in command and the state continues to prevail in China, even with the large scale economic reforms in recent years. Thus while conforming to the on-going economic reforms and deregulation in other developing economies, China seems to have avoided reforms at a political level with the continuation of the state- authority in terms of its one-party rule and its close control on policies.

The Indian political system is very different from that in China, with a democratic form of government which is supposed to let opposition parties as well as civil societies have a say in the shaping and implementation of policy. The pace of economic reforms in India, which started in its full swing by 1991, has been continuing since then, despite the changes in regimes led by alternate parties which were ready to carry those forward. Having political opposition, as in the democratic set up, while partly modifying their implementation, has not stalled the on-going process of reforms in the economy.

The formal launch of economic reforms in India in 1991, while initiating the market in different spheres of the economy, subdued the role of the state, as compared to what it had been earlier with state-led drive for industrialisation during the first two to three decades of India's independence in late 1940s. The rapid stride of liberalisation and privatisation since the 1990s has severely affected the life of the common man (and woman) who are experiencing hardships in their daily life, especially with hikes in the rates for public services as well as in food prices. Delegation of responsibilities by the state to the private agencies for construction of major infrastructures like dams, roads, bridges along with the

offer of incentives to large-scale export zones and industrial units have often meant displacements of the poor in the name of so-called development. Clearly, the market has failed to provide the much needed facilities for common people in way of the sustenance of their livelihood and the offer of basic civilian amenities .

A democratic pattern of political system, as long does not get paralysed by a rise of fascist majoritarian moves, can generate what Karl Polyani<sup>1</sup> identifies as a “double movement”. The latter is characterised by protests, of people from civil societies, opposition parties or similar other groups - which usually generates responses on part of state. As pointed out, the pattern originates from a set of countervailing forces in societies to sustain the ‘mutually supportive relations’ therein. With markets expanding under capitalism, it tends to subordinate the society and destroy the social fabric by using the standardized capitalist values which are embedded in the culture of the global market. Above involves a violation, both the basic human nature as well as such other requirements of indigenous people as are fundamental and intertwined with family, community and social relations As mentioned by Polyani, unlimited expansions of the capitalist system and the market, while generating output growth and accumulation, are responsible for causing “dispossession, displacement and human degradation”.<sup>2</sup>. Thus markets in this view (with their adjunct, which is capitalism), are sustainable only when it can at least be partially “embedded” in society; with attempts on part of institutions , which include the state, to act in conformity with the preferences of the society. Above, in principle can be done by regulating and stabilising the market economy to achieve some degree of political legitimisation which, however, often meets with a failure.

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<sup>1</sup>Karl Polyani, The Great Transformation: The Political and Economic Origins of Our Time Beacon Press 1944

<sup>2</sup> Kari Levitt ,” Karl Polyani as a Development Economist”in K S Jomo(ed) Pioneers of Development Economics Zed Books 2005

India went through a series of measures to implement economic reforms, the speed of which quickened, especially after entering the conditional loan programme of the IMF in 1981. The pace, however, quickened with the formal launch of a comprehensive economic reforms in 1991. Following the Fund-Bank advocacies relating to the stabilisation package, a ceiling on fiscal deficit was instituted in 2003 in terms of the Fiscal Reforms and Budget Management Act (FRBMA) which considerably restrained public expenditure relating to investments as well as the social sector. Implications of above were quite severe for the common people, in terms of employment, infrastructure and welfare measures.

In the monetary sphere there has been a two-fold responsibility for the Central Bank (the Reserve Bank of India) to control inflation and manage the exchange rate. With large inflows of short term capital which have been encouraged by the steady deregulation of capital flows, exchange rate management by the central bank implied official purchases of foreign exchange which was kept as reserves. The latter too was a cause of worry in terms of the possible inflationary consequences and led the monetary authorities push further its goal of inflationary targeting. Between those efforts, credit supply had a tendency to be squeezed, adding further to stagnationist tendencies in the economy.

The steady process of capital account opening in India which, since 2003, has allowed free entry to Foreign Institutional Investors (FIIs) in the country's stock markets also created ample opportunities to speculate and arbitrage. With a steady pace of de-regulation in the financial market, options are thus opened to speculate with trade in derivatives having a major role. One can confirm, from available statistics, the current tendencies in India's corporate sector to switch their portfolio in favour of financial assets.<sup>3</sup>

On the whole, labor in India has been subject to a dual process of expropriation with stagnant growth in the major sectors of the economy (which include industry and agriculture, both growing at less than 2% during 2012-13<sup>4</sup>) and the repressive labor legislations, Unemployment, poverty, malnutrition, food shortages, speculation and rising food prices, agrarian distress with farmer suicides, widening disparities and aspiration gaps prepare the grounds for protests which in recent years are widespread in the country.

The mediating role provided by the Indian state here assumes a great degree of significance in the liberal market economy, with the state subject to an 'existentialist contradiction', between unfettered competition and expansion of capitalism on the one hand and the political necessity

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<sup>3</sup> Sunanda Sen, "Financialisation and Corporate Investments: The Indian Case" Levy Institute of Economics Working Paper No 828 January 2015

<sup>4</sup> Government of India Economic Survey 2012-13 p3

of sustaining a minimalist façade of a mutually supportive and self-reinforcing society on the other.

As for China, political parameters in which have been entirely state-driven, the pattern is rather different from the one under a democratic set up like India. The moves by China's state, however, as already mentioned above, were closely controlled, in terms of the one-party system, by the communist party. However, the perception of the party, has gone through changes over time, as reflected in official policies over time. Examples include the contrast between the earlier pattern of what we describe as 'guided finance' with banks closely guided by the state council in gearing their credit policies to facilitate industry. Controls were there over foreign capital by restraining trade in stocks denominated in US dollar only to those identified as Qualified Foreign Institutional Investors while stocks in RMB remained as a separate category, traded by domestic agents. Controls over capital flows were effective in sustaining inflows of long term FDIs which also generated exports. China's financial sector was considerably rejuvenated by recapitalising the state owned banks which thus could get rid of the NPAs, largely due to the problems faced by the defaulting state owned corporations. Finally the guided regime of finance also held the rein to a tightly managed exchange rate of the RMB in terms of US dollar which continued to remain nearly fixed at around 8 RMB to a US dollar till 2005. As claimed by the officials, "... Yuan rate is at our own terms".

Reforms started by Deng Xiaoping's big push to China in 1978 continued even after he left the premiership in 1991, to be followed by Li Peng and later by Zhu Rongji who succeeded. China, however, by this time was already experiencing double-digit growth in her economy and the twin surpluses in her external accounts. The latter, in particular, was now sought to be facilitated further by easing out the restrictions on international capital flows. The year 2005 witnessed a significant move by the PBoC in terms of which RMB rate was no longer fixed to dollar. Its movements in the market led to an appreciate by 20% within the next few years when the world was hit by the global crisis. Also the qualified foreign institutional investors (QFIIs) were permitted to handle the RMB (A) shares subject to specified lock up periods.

Facing the global financial crisis of 2008, China made use of its relative ease in handling finance by injecting large sums around \$586bn in the domestic economy, largely by relying

on fiscal expenditures. <sup>5</sup>The impact, while taking care of the possible contractions as could result from the downward squeeze in exports, was responsible for generating a real estate boom which ensued in the following years. Above was also due to the rising inflows of short-term capital as resulted from the further opening up of the economy to global capital by this period. Thus China was no longer immune from shocks to the capital market as can be seen from the turbulences in the Shanghai stock market during the 2008-09 crisis.

China's capital market, which became virtually open to capital inflows of different maturities by this time, contributed additional responsibilities to the monetary authorities in managing the exchange rate along with the interest rates. A major consequence of above has been what the countries in similar situations have faced as a 'trilemma', of managing both the nominal exchange rate as well as monetary policy while keeping the capital flows uninterrupted. For China the consequences included the use of monetary instruments (interest rates and reserve ratios) in a manner which had more to do to with volatility in external capital flows on the exchange rate than coping with the changes in the domestic economy. China's financial links with Hongkong has often been discussed in the literature as one which provides opportunities for round-tripping of funds by speculators. From 2004 China made Hongkong as an offshore financial centre. In a few years London and Singapore were also got the status of offshore centres for dealing in Rmb. This happens with the exchange rate of the RMB in Hongkong different from what it is in Mainland China, as can be seen from the current rate of Hongkong dollar (CNH) in terms of RMB slightly lower than that in the mainland as CNY<sup>6</sup>. Recently China has taken a major step in announcing Shanghai as a free trade zone along with the facilities to have full convertibility of the RMB within the free trade zone of Shanghai. The proposal was formalised at end of a high-powered meeting of the Chinese Communist Party in November 2013. Granting Shanghai a similar status as Hongkong, however, makes it possible to have two-way convertibility of RMB within the mainland, which is a major step in the direction of Yuan convertibility which again, is much talked about at present.

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- <sup>5</sup> China announced a historic \$586 billion stimulus package aimed at encouraging growth and domestic consumption in ten areas of Chinese society ranging from infrastructure investment to environmental protection and disaster rebuilding.  
<http://chineseculture.about.com/od/thechinesegovernment/a/Chinaeconomy.htm>

<sup>6</sup>See Sunanda Sen, "Deregulated Finance in China: A Critical Analysis" in Kevin Gallagher et al, Capital Account Liberalisation in China: The Need for a Balanced Approach GEGI, Boston 2014

China's exchange rate, both with a fixed rate maintained till 2005 *vis a vis* dollar and later, with managed floating, has been questioned, especially by United States with allegations that the rate has remained undervalued, despite the slow but steady appreciations in recent times. In the meantime China has been active in projecting its currency as a potential reserve currency with full convertibility in terms of other hard currencies. The move is being supported by the arrangements for cross-border trade settlement, especially with neighbouring countries, which has been expedited since 2011. As recently estimated by the Bank of China, trade denominated in RMB has been 11.7% in 2013, thus making the currency the second largest as means of trade settlement for China. Moreover, use of offshore centre like Hongkong has facilitated the transactions in RMB, not only for trade but also as assets held as RMB (Dimsum) bonds and direct investments. The latter reflect the willingness of foreign investors to hold assets in Chinese currency, thus adding to its acceptance as a potential reserve currency. Opening up of the Shanghai free trade zone will be one more opportunity in the same direction.

Of late China has been engaged in working out closer economic relations with the major emerging economies within the framework of the BRICS. The institutions created through this include the \$50bn New Development (or Brics) bank, \$100bn Contingent Reserve Fund (CRF) and the newly launched \$100bn Asian Infrastructure Investment Bank (AIIB). All of the above, and the last one in particular, affiliated by 40 odd nations from all over the world as founder members, has been vehemently opposed by US. China clearly has posed a crack if not a threat to the hegemony of the dollar and the BWIs in the world economy. Brics may pose an effective threat to the advanced economies in the West in view of the steady declines in their share of China's trade relative to the share for the developing countries which has been rising.

Looking more closely at China's strategic moves to establish RMB at the centre-stage of global trade and finance which has rested on multiple channels of liberalisation, especially of capital flows, one can relate to the share of her savings in GDP which of late is more than 50%. Above include savings by corporates, the government as well as the households, with the latter at 35% of GDP which speaks of the rather low propensities to consume by households. One can infer that China today wants to make use of the large share of its GDP by investing abroad, which is strategically much easier when RMB is universally acceptable, not only as a vehicle of transaction but also as a store of value. One can not miss out here the pressure exercised by the wealthy section of the population on policy makers for better

opportunities to diversify their portfolio. Evidently, directives of the party over the major policy making institution, the National Peoples' Congress reflected above changes in China which today has marked inequalities in income and wealth.

Policy makers in China, however are aware of the imbalance as above within the economy, especially in terms of uneven distribution and inequality and continued dependence on foreign investments as well as the export market for contributions to its GDP. Faced with intermittent variations in the global financial markets as well as the ongoing stagnation in advanced economies, China of late has charted out a strategy of creating a "new normal" economy by boosting domestic consumption and employment which will expand the domestic market with potentials to absorb the surplus savings. This will be combined by a slower pace of growth at 7% or so, and with cuts in gross fixed capital formation, which had been as much as 47% of the GDP in 2012. Despite the rule and controls under the one-party system in China, discontents and protests have been not uncommon, and the party possibly has to make space in policy making, both to take cognizance of such discontent within the country and to ward off the possible impacts of a volatile global economy on China.

It does not require much to observe that the emphasis recently laid by China on her plans to set up a "new normal" economy speaks of a move, if not a "double movement" as in Polyani, is at least different from the on-going policies in China to make RMB a fully convertible international currency. The two possibly reflect the dual concerns of the party along with the state, with needs for rebalancing the economy for sustainable development co-habiting with the push by those who have acquired wealth to have access to the international capital market.