

State and Capital in Chinese and Indian Economic Development

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Coexistence of Different Types of Capitalism in both Countries

- **Entrepreneurial Capitalism**
- **Rentier Capitalism**
- **State Capitalism**

Different History of **Entrepreneurial Capitalism** in the two countries in recent decades

In India the formal private sector, more vigorous than in China,

- **Less constrained in access to finance and equity markets**
- **Less clientelistic in relation to political authorities, compared to China**
- **Corporate governance somewhat more transparent than in China**
- **But more constrained by India's weak infrastructure**

But the much larger informal sector in India, facing severe constraints in credit, marketing and infrastructure

China's guanxi capitalism from below mobilizing informal finance and networks, as described in book by Nee and Opper (2012)

Private enterprises, which originally started operating below the radar (often with their 'red hats' on), now contribute more than half of manufacturing value added in China

(of course, some problems in defining the boundaries of private and public control rights within a firm; examples from even the most well-known private companies: Lenovo, Huawei, Geely)

Most big private companies have active cells of the Party inside them. Many successful private companies (including some of the recent private equity firms with opaque operational methods and backed by local governments) are run by 'princelings' and other relatives of Party officials.

More involvement of private enterprises in China than in India in foreign investment and joint ventures, allowing a considerable scope for technology upgrading and marketing connections

In matters of commercial law political interference, though still substantial, is declining in China. Corporate governance is improving particularly for companies quoted in foreign stock exchanges.

India, of course, has a stronger rule of law with independent judiciary, but the courts are often clogged, leading to long delays, and are sometimes corrupt, particularly at the lower levels. SEBI, the regulatory body in equity markets, and the National Stock Exchange more transparent and autonomous, than similar institutions in China.

Rentier capitalism in both countries thriving on the fast rising value of politically allocated scarce resources: land, minerals, oil and gas fields, telecommunication spectrum, etc.

Since faster economic growth has raised the value of these resources more in China, and since there is less political competition in Chinese politics, rentier capitalism, drawing upon monopoly rights of various kinds and privileged access to finance and government contracts and procurement, is likely to be much more prevalent in China than in India (also, maybe stronger in the interior provinces than in coastal China).

In both countries collusion between local politicians/officials and commercial interests leads to arbitrary land acquisition and toxic pollution, but local officials are more powerful to do this with impunity in China than in India.

State capitalism is stronger in China.

Large state companies dominate in transport, energy, basic metals, finance and telecom, more in China than India.

Some of the Chinese SOE's are now important players in the global market competition. They are often highly commercialized: in recruiting professional managers, broadening their investor base, and shedding their earlier bloated labor force and traditional social and political obligations, many SOE's do not conform to the usual stereotypes about SOE's.

China laid off more than 30 million workers from state and collective-owned urban manufacturing enterprises in just five years—1995-2000; if this is not '**shock therapy**', what is?

If India tried even a fraction of this, either in the size of layoffs or the shedding of pension and welfare obligations of SOE's, there would have been a huge political upheaval, and no government would have survived the electoral repercussions.

Indian SOE's are often much less commercialized and less free of interference by the relevant Ministries, and their corporate restructuring (including shedding of welfare obligations) far less advanced.

But some Chinese SOE's are controlled by powerful political families, and most senior executives are screened for loyalty by Zhongzubu, the Central Organization Department of the Party. There is a tighter inter-penetrating relation between business and politics in China, more than in India.

The Economist magazine reports that in early 2012, 17 prominent Chinese political leaders were at one time senior executives in large SOE's, and 27 prominent business leaders were serving on the Party's Central Committee.

There is a new political-managerial class in China which over the last two decades has converted their positions of unaccountable authority in an authoritarian country into unprecedented wealth and power.

- A report from Hurun, the Shanghai-based monitor of wealthy people in China, suggests that in 2011 the 70 richest delegates to the National People's Congress (NPC) in China had a net worth of about \$90 billion.**

- If you look at the accounts of (declared) assets of the members of the Indian Parliament, the corresponding total wealth of the 70 richest of them will be less than half a billion dollars.
- Six of China's 10 richest individuals serve on either the NPC or the Chinese People's Political Consultative Conference, the political advisory body.

The collusion between Indian billionaires and politicians is somewhat less direct, and more subject to political scrutiny.

The web of nepotism and political connections involved in **Rentier** and **State Capitalism** constitute elements of what is called 'crony capitalism', which is probably more rampant in China, even though it is significant in India as well.

But there are checks on the power of crony capitalism in China from **more market competition**, both global and inter-regional. Also, **career incentives** in the Party hierarchy, that give considerable weight to aggregate economic performance and fiscal revenues for the local area, put limits on the rent extraction by an entrenched elite.

The institutional checks and balances are, of course, stronger in India

- More vigilant media
- Independent judiciary (active in public interest litigation)
- Independent Comptroller and Auditor General of India
- Right to Information Act
- A more active NGO movement as watchdog

If Party-state connections in the accumulation process are so important, is China really capitalist?

While the potential arbitrariness of political control can interfere with the internal dynamic logic of capitalism in China, one cannot deny the essential capitalistic nature of the whole system. While the Chinese leadership **can undo individual capitalists** at short notice (in recent years some of the richest men of China have been put in jail), it will find it much more difficult to **undo a whole network of capitalist relations**, by now thickly overlaid with vested interests at various levels.

There are now 5 million registered private enterprises with \$1.3 trillion in registered capital. Even a highly authoritarian state cannot/will not re-bottle such a massive unleashing of the entrepreneurial spirit.

Individual entrepreneurs may have a clientelistic relationship with the state, but the state is now sufficiently enmeshed in a profit-oriented system that has been identified with legitimacy-enhancing international economic prowess and nationalist glory, a tiger the political leadership may find difficult to dismount.

Also, as discussed in the Li-Liu-Wang (2012) paper, the Chinese economy is largely **dualistic** in a vertical economic structure, with the state deriving profits and political rent from its monopolistic control in the upstream sectors ('the commanding heights') that provide capital and inputs and services to the successful downstream largely private (including joint-venture) or hybrid sectors. So the Party-state may not want to kill the latter sectors that lay the golden eggs for the former.

In the technological 'catch-up' phase (using off-the-shelf technology, copying, learning, etc.) the Chinese development has shown some similarities with the earlier Korean and Taiwanese cases, but there are major differences.

The Korean state allowed domestic private conglomerates (chaebols) 'cooperation-contingent rents' (through subsidized credit and sectoral oligopolistic profits in the domestic market) but the firms were disciplined by the need for competitiveness and quality consciousness in export markets.

The same discipline was there in Taiwan but firms were smaller and this had some resemblance to the guanxi capitalism of the Chinese private sector today (but without as much involvement with foreign investors). The much larger size of domestic market has given China the bargaining leverage to get from foreign investors the advanced technology with the bait of the market size.

As emphasized by Lee, Jee and Eun (2011), other special features of China's technological catch-up, mostly absent in Korea and Taiwan cases, were the adoption of foreign technology and brands through international mergers and acquisitions and the role of spin-off firms of universities and research institutions.

Ernst and Naughton (2012) give examples from the integrated circuit design industry: Away from the government-sponsored attempts at 'indigenous innovations', China seems to be more successful in innovating in areas that involve global technology sourcing and quickly responding to changes in the increasingly fine divisions of the global value chain.

But there is evidence to believe that for the **too-big-to-fail state-owned companies and politically-connected private firms** in China may have led to a serious misallocation of capital (and managerial talent) and build-up of excess capacity. Such misallocation may have more bite in future as saving and investment rates come down. Meanwhile entrenched vested interests of the political elite make resistance to change stronger.

In some sectors it might start hurting productivity by blocking entry of new firms and exit of inefficient ones, spelling trouble for China's innovation prospects in future, even though China is investing a large amount of resources in R and D (as percentage of GDP nearly twice as much as India).

Also, an atmosphere of tight control over a free flow of ideas and creativity and self-censorship will curtail innovations (particularly those that are likely to be disruptive, not just incremental).

Without innovations, China cannot sustain its dazzling high rates of growth achieved in the hitherto technological 'catch-up' phase particularly in the industrial sector, as the artificially low prices of land and capital for politically favored firms become difficult to maintain and the supply of cheap labor gets exhausted.

In India there is evidence of dynamic entry of new firms in the corporate sector in recent years, but the concentration of large firms in manufacturing continues.

The future of Indian capitalism will depend on

- **how quickly public and private investment can strengthen India's currently rickety infrastructure**
 - **can educate and train India's younger population.**
- India's so-called demographic dividend may not materialize if the states where the fertility rates have been high continue to be economically backward and poorly governed.**

In the governance sphere, career incentives for Chinese local officials are more oriented to the goals of the top leadership whereas in Indian civil service promotion is largely seniority-based and less oriented to those goals. Following a long tradition, **the Chinese system is more politically centralized but administratively and economically decentralized** (even after the centralizing tax reforms of 1994)

India is more politically decentralized (at least to the provincial level) and fragmented, **but administratively and economically more centralized.**

Vertical fiscal imbalance in India, particularly acute at the sub-provincial level (of total government expenditure, more than 55 per cent in China is at that level, but in India it is about 5 per cent). State capacity and autonomy to build infrastructure and provide social services at the municipal and village levels are much poorer in India, even though local elections are quite vigorous. Lack of fiscal resources and lack of inner-party democracy in all major political parties make local democracy in India largely ineffective in local development.

In China with lack of political accountability to the local people, local officials often ride roughshod over them, and the higher-level authorities find it difficult to control them, leading to widespread unrest, which the authorities then try to contain and localize.

As inequality rises with capitalist development, the state in both countries is responding positively, but

- China has much more public surplus to fund education, health and pension projects.**
- The short-term electoral goals in India often lead to pandering, as a result of which redistributive pressures tend to get frittered away in populist subsidies and handouts (in food, fuel, fertilizers, water, electricity, railway passenger fares, etc.), at the expense of pro-poor long-term investments (like roads, electricity, education and public health).**

- **In China populism takes mainly the form of wallowing in nationalist glory and a kind of nationalist petulance. The state tries to manipulate this by stoking public anger against foreign conspiracies, and by building wasteful gigantic 'image projects' and organizing over-orchestrated spectacles.**

- **The tension between capitalist growth and the dispossession and displacement of people and environmental degradation it brings about is central in the development debates in both countries. The social activist movement, often backed by an active judiciary, being stronger in India, already serious constraints on growth have come up. How the state reacts to this tension will be a major issue in the development of capital in both countries in the coming years.**