# The Paradigm of Capitalism under a Developmental State:
# Does it Fit China and India?

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In both countries some form of weak capitalism had developed for many decades long before Liberation/Independence.

After the latter point China, of course, installed a socialist economy both in industry and (after mid-50's) agriculture, and the private sector was minimal and operated in minute scale and under the shadows.

India for the first four decades after Independence had a much larger private sector, but many of the key and strategic industries were in the public sector, sometimes co-existing with the private sector in the same industry (for example, steel) and in other cases not (for example, power plant equipment or airlines). The Indian informal sector (including both farms and household enterprises outside agriculture), much larger than that in China, has been mostly private-owned; even now it employs nearly 94 per cent of the labor force and contributes about 45 per cent of non-farm output. But many of these tiny enterprises, while often family owned, cannot be quite described as capitalist business; if market prices are imputed for the inputs they use (like family labor) their business income is often negative and persistently so.

‘Billions of Capitalists’? (Prestowitz, 2005)

Those who envisage ‘billions of new capitalists’ in China and India do not realize that hundreds of millions of poor people in either country are currently scrounging a living from tiny family enterprises of extremely low productivity. They don’t have the kind of access to credit, marketing, and infrastructure or the basic skills and education and risk-bearing capacity that can make a capitalist enterprise possible. They are there because the capitalist parts of the economy (under state or private auspices) cannot absorb them.

In the last two decades the private corporate sector has thrived in India, even though in the formal sector state-owned companies still account for about 40 per cent of total sales. The informal sector, though still quite large, has developed output and supplier links with the formal sector, and the communication revolution has strengthened those links. But a recent study by Alfaro and Chari (2009) on Indian corporate data over 1988-2007 show that in spite of a great deal of new entry, particularly in the service sector, the dominance of incumbent state-owned and business house-controlled companies in the over-all industrial scene continues unabated, in spite of two decades of economic reform.

Given the ideology of the long-ruling Party, the transition to capitalism in China is the more fascinating, and still somewhat contested, story. Most people will agree that in China while the Party retains the monopoly of power, much of the economy is no longer a ‘command economy’, with market mechanism being the major allocator of resources. About 95 per cent of consumer prices are now market-determined, though the state still controls prices in some key sectors (like financial services, telecoms, utilities and energy).

But is the economy primarily capitalist now, with private owners of capital providing the dominant mode of organizing social and economic life through their drive for profit-making and accumulation?

The answer is still somewhat ambiguous, but with some telling straws in the wind.

First, how quantitatively important is private ownership now?

It is not easy to classify Chinese firms by their ownership or to distinguish between private control rights and other forms of public or semi-public control rights or to trace their varying shares in a firm. Huang (2008) shows how convoluted the ownership structure is even in China’s most successful private-sector firm, Huawei Technology Corporation

Some evidence to suggest that the private sector now contributes over half of industrial value added (though not of fixed capital investments).

But the relationship between private business and the state is often rather clientelistic. They provide support to the state leadership and accept its pervasive control and guidance; they are more interested in a predictable business environment than in full democratization of the polity, and in exchange get political legitimacy and protection, better access to state resources, and at the local level, even partnership with officials.

Of course, it is well-known that some of the entrepreneurs are in fact friends or relatives of Party officials. (A study by the State Council of the Academy of Social Sciences and the Party's Central University has found that of the 3320 Chinese citizens with a personal wealth of 100 million yuan in 2007, about 2932 were children of high-ranking Party officials).

In any case there is a new political-managerial class which over the last two decades has converted their positions of authority into wealth and power. The vibrancy of entrepreneurial ambitions combined with the arbitrariness of power in an authoritarian state has sometimes given rise to particularly corrupt or predatory forms of capitalism, unencumbered by the restraints of civil society institutions.

(Perhaps nowhere has it been as starkly evident as in the real estate boom of the recent past in cities where the commercial developers in cahoots with local officials have bulldozed old neighborhoods, residents waking up in the morning to find that their house has been marked for demolition with the Chinese character *chai* (meaning ‘raze’) painted in white, with hardly any redress or adequate compensation available.)

The state is still predominant in the producer goods sectors and in transportation and finance. The state still controls the larger and often more profitable (high-margin, more monopolistic) companies in the industrial and service sectors. The SOE’s are often highly commercialized: in recruiting professional managers, broadening their investor base, and shedding their traditional social and political obligations, many SOE’s do not conform to the usual stereotypes about SOE’s.  Some of the SOE’s are now market leaders in technology, cost control, design and marketing—-the areas of traditional weakness of SOE’s. SOE’s like Chery Automobile (the majority share-holder of which is the municipal Government of Wuhu), Baosteel, Chinalco, Shanghai Electric, have become market leaders in their respective arenas in the domestic market, out-competing some reputed foreign companies

The state's role in regulating the private sector also goes far beyond the usual functions in other countries—

- in bargaining the terms of foreign investment,
- negotiating the border prices of imported materials,
- channeling finance and investment to favored sectors,
- directing consolidation and merger of firms, and
- in promoting industrial capabilities across sectors and regions.

An important question arises in the cases where an enterprise is managed on essentially commercial principles, but the state, say at the local level, still owns or has control rights over a large share of the assets: is this a capitalist enterprise?

--Some may describe it as capitalist if the principle of shareholder value maximization is followed (but this principle is not always followed in capitalist countries either—Japan or Germany?).
--Others may point out that as long as substantial control rights remain with the state, which is subject to potentially arbitrary political influence, the internal dynamic logic of capitalism is missing.

The actual situation is, of course, even more fluid, as there are different degrees of state control rights, and with recent changes in stock ownership laws markets have become more liquid, loosening the control of state authorities over companies.

Even if the Chinese economy is described as capitalist now, it will be a travesty to deny that the earlier socialist period provided a good launching pad in terms particularly of :
• a solid base of minimum social infrastructure ( broadbased education and health) for the workers;

• a fast pace of rural electrification that facilitated growth of agro-processing and rural industrialization;

• a highly egalitarian land redistribution, which provided a minimum rural safety net, that eased the process of market reform in the initial years, with all its wrenching disruptions and dislocations;

• a system of regional economic decentralization (and career paths of Party officials firmly linked to local area performance)-- for example, county governments were in charge of production enterprises long before economic reforms set in (creating a pool of manufacturing experience, skills and networks) and, drawing upon this pool the production brigades of the earlier commune system evolved into the highly successful township and village enterprises that led the phenomenal rural industrialization

• the foundation of a national system of basic scientific research and innovation (even in 1980 public spending on research and development as per cent of GDP was higher than in most poor countries)

• large female labor participation and education which enhanced women's contribution to economic growth.

Some analysts find in China elements of the 'developmental state', a familiar idea from the earlier East Asian growth literature.

- ✓ The financial system has been at the service of a state-directed industrial policy. Successful private companies in China like Huawei and Lenovo have benefited a great deal from their close ties with the Government.
- ✓ Like in the rest of East Asia export promotion combined with domestic technological capacity building and state encouragement of trial and experimentation in exploring dynamic comparative advantage sometimes at the expense of static allocation efficiency have been at the core of the development strategy.

Yet the Chinese case is also qualitatively different from the standard ‘developmental state’ of East Asia in several respects:

- Because of a different history of evolution of the private sector, that grew in the interstices of market reform in a socialist economy, the nature of ‘embeddedness’ of the developmental bureaucracy was quite different in China. In contrast to the coordinated capitalism of Japan and South Korea (where the state presided over the coordination among private business conglomerates), the Chinese case can be, and has been—see McNally (2007)--more aptly described as one of state-led capitalism from above and network (*guanxi*) capitalism from below to fit in the conditions of much weaker development of large private business in China; with a large number of small family-based businesses forming clusters with informal credit and trade links among themselves and with the diaspora
- Industrial policy has also been more diverse and diffuse in the context of regional variations and

decentralized development in a continental-size economy

- Foreign investment has played a much more important role in technological and organizational upgrading and international marketing than in the other East Asian countries. This is not unrelated with the weaker development of large private business in China.

The Indian case has also been quite different from the East Asian developmental state. While private business houses have a long history in India, in the first three decades after Independence they were relatively subdued and largely played a subsidiary role to the state leadership and privileged state production in the strategic and heavy industries, and learned to work out niches and modes of operation in a heavily regulated industrial environment.

The bureaucratic elite was not particularly probusiness, neither by inclination or ideology, nor in terms of social composition. In any case the tightly-knit links between business and officialdom of the East Asian type were difficult to forge in India where elite fragmentation in an extremely heterogeneous society and the exigencies of populist electoral politics make such tight links politically suspect.

Yet compared to the past, in the last couple of decades the link between the political or bureaucratic leadership and business associations (like CII) on the matter of economic reform has been important in pushing the market principle and in slowly establishing the general hegemony of capital in the political culture. Some of the new entrepreneurs, belonging as they sometimes do to the families of bureaucrats, army officers and other members of the professional classes or sharing ties through education in elite engineering and business schools, have forged new links between the bureaucracy and private capital. The incidence of such linkage has been stronger in some industries and regions than in others, and different state governments have been business-friendly to a different extent. In some regions (particularly west and south India) local connections between the upcoming new capitalists (many of them from agricultural castes) and political organizations and authorities flourished—-as in the case of the Kammas in Andhra Pradesh, Patidars in Gujarat, the Marathas in the sugar cooperatives of Maharashtra, the Gounders and Nadars in Tamil Nadu, etc. The regional political imperatives were, of course, different in different parts of India and, accordingly, the institutional practices and outcomes were sharply different, as the contrasting cases of Gujarat, Tamil Nadu and West Bengal show.

Sharp differences in institutional practices are also common in China. Huang (2008) has contrasted the private indigenous entrepreneurial model of Zhejiang province with the state-led capitalism of neighboring Shanghai or even Jiangsu province (with a prominent role of foreign investment). He considers the

Shanghai model that has attracted a lot of attention the world over — as much as the skyscrapers of Pudong--as one of highly interventionist industrial policy, urban-biased, restricting the development of small-scale entrepreneurial businesses, privileging foreign, as opposed to indigenous, private business, resulting in low innovations, rapid but relatively 'jobless' growth, low labor income share, and high income inequality.

Pinglé (1999) shows how in recent years in some industries in India (for example, in computer software) bureaucrats have even acted as policy entrepreneurs and worked closely with private business with a kind of shared understanding and informal channels of communication and a goal of fostering private entrepreneurship. In some cases strong intra-bureaucratic ties and cohesion have enabled the policy entrepreneurs to withstand interventionist political pressure. This has not, however, been the case in India’s steel industry. The managers of the public sector Steel Authority of India Ltd. (SAIL) were hemmed in by the interventionist IAS bureaucrats in the Ministry of Steel above and the contentious labor unions below who were in historical association with politicians. In contrast the state-owned automobile firm, Maruti Udyog Ltd. (MUL) was managed better, largely due to better channels of communication and a non-hierarchical relationship between the IAS bureaucrats and senior MUL management. The alliance between managers and bureaucrats allowed it to innovate in the matter of corporate strategy and industrial relations, in particular to handle intransigent unions more effectively than in the steel industry. In the labor repressive regime of the East Asian developmental state the business-bureaucracy alliance had to worry much less about methods of maintaining good industrial relations than in the active adversarial set-up of a fractious and fragmented union movement that characterizes the Indian labor scene.

In both countries there are some elements of capitalism under a developmental state, but the complexity and diversity of economic relations in either country make it difficult to fit them into neat conceptual boxes.