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Quest: Dr. Li, can you talk about some of the recent reforms in China?

Li: Summarizing China's reform of a quarter of a century is not an easy task. The Chinese Communist Party won a 10-year civil war in 1949, and has been ruling China ever since. For nearly the first 30 years after the war, the country was ruled by Mao Zedong, whose extremely revolutionary policy drove China into absolute poverty. In 1976, when Mao died, China was on the verge of a total collapse. The whole country was longing for change. Deng Xiaoping, a practical communist leader who succeeded Mao, seized the opportunity and started economic reform. However, Mao's revolutionary legacy was very strong and any move toward a free market could be termed as "capitalistic," and easily killed on ideological ground for being "anti-socialism." Deng and his associates designed two strategies that proved to be very clever. First, he downplayed the communist ideology and restored the mercantilist tradition in China. Two of his most famous slogans are "Getting rich is glorious" and "It doesn't matter whether it is a black cat or a white cat; as long as it catches mice, it is a good cat." Second, he

allowed foreign investors in China, who not only brought in capital, but also capitalist ways to every aspect of social life: economic governance, business culture, free competition and Western lifestyle.

Throughout the period, the Communist Party maintained tight political control and crushed any opposition and challenges, while it allowed people much personal and economic freedom, as opposed to political freedom. The result was phenomenal: from 1978 to 2002, personal income increased 22-fold and foreign direct investment increased from virtually zero to \$55 billion. However, in terms of building the infrastructure of a mature market economy, China has a long way to go. Many industries still have high entry barriers, the Chinese currency is not convertible, protectionism is strong, protection of property rights is very weak, and the legal system is not independent and transparent.

Quest: The India story is less known. Dr. Nair, can you offer an overview of what has happened regarding India's economic reform and development?

Nair: Roughly around the same time that the Chinese Communist Party seized power, India achieved independence from British rule in 1947. Like China, India was a large developing nation seeking its own path of development. However, the similarity stops here. India's quest for development is different from China's in almost every aspect. Although (Mahatma) Gandhi is best known as the founding father of modern India, it was (Jawaharlal) Nehru, another founding figure of modern India, who shaped the developmental path of India. Nehru steered India toward a "Fabian socialist" policy, which advocates the state's playing a dominant role in the economy while maintaining a minimal private ownership. However, the legacy of the British rule left India a well-developed common law system that, according to political economists, provides the best protection of property rights among all legal systems in the world.

From 1950 to 1980, India's economic growth was slow due to the heavy burden of state ownership and bureaucracy, but steady and better than China's under Mao. In the mid-1980s, the Indian leadership began to initiate some reform measures, but they were halfhearted at best because, unlike China, India was never under strong internal pressure, as was China, to start economic reform. Soon a corruption scandal erupted and lack of popular support aborted this first attempt. In the early 1990s, a severe foreign currency reserve crisis, triggered by the Gulf War and the collapse of the Soviet Union, pressured the leadership to undertake a second, and more serious, effort to reform the economy. Despite frequent impasses in the parliamentary democracy, where many small parties could use their votes to swing policies, the reform has produced substantial results and caught the world's attention. Deficits are being cut; privatization is well under way; markets, including the financial market, are more open; tariffs are substantially reduced; and foreign exchange rates float freely.

India is becoming a global hub for software development and is currently one of the largest destination countries for outsourcing. Buoyed by these achievements, the Bharatiya Janata Party-led coalition government decided to hold the national election almost six months ahead of schedule to exploit the perceived economic boom. But the plan backfired. The incumbent BJP was voted out by the rural voters who, according to many analysts, were left behind by the economic reforms.

Quest: From the standpoint that academic studies are supposed to extract a general pattern from seemingly random events and offer explanations for their findings, what do you make of the two stories?

Nair: Most studies on India and China have stayed at the storytelling level and failed to offer a general pattern on what determines the pace of reform. In order to systematically analyze the two countries' reform experience, we developed a model using institutional theory, a powerful framework to explain how and why organizational, social or economic practices get taken for granted, persist and change. Our model first examines the initial conditions of the reform. The degrees of crisis that triggered reforms in these countries are very different. The economic crisis in Mao's China was deep and widespread, which made the reform more urgent and easy to show positive results. In contrast, India has never faced such a devastation; the source of crisis that triggered its reform was external (foreign currency reserve), and the expected results of the reform were incremental, making India's reform less radical and more hesitant.

The second issue we identify as important are the risks and incentives faced by the political leaders. Non-democratic regimes do not need to worry about opposition or public opinion – at least while they firmly control the power. Thus, they can more effectively and efficiently design and carry out reforms. In a parliamentary democracy such as India, the incumbent always worries about the support from other parties and the voters when designing and carrying out reforms, thereby sometimes reducing their effectiveness and efficiency.



Quest: Dr. Li, what are your thoughts?

Li: We also examined the resources available for implementing the reforms. The Chinese leadership relied heavily on foreign investments to carry out their reform. Foreign investment filled the vacuum in the capital market and also brought capitalistic institutions. In the case of India, the need for foreign investment was less urgent, since there was a domestic capital market and market institutions existed before the reform. The reliance on foreign resources gave China a jump-start.

The final element is institutional arrangements of the two countries. Institutions are the rules by which economic activities are regulated. They include “hard,” or formal, rules, such as laws and regulations, and “soft,” or informal, rules, such as conventions and customs. In order for institutions to function effectively and efficiently, the hard and soft rules must be consistent. For example, a pro-market law coexists with a pro-market culture. Economic reform can be viewed as institutional change, namely, changing anti-free market rules, such as state monopoly, to pro-free market rules, such as free trade policy. In China, a pro-market culture, or soft rules, was being rapidly established by Deng with the influx of capital and lifestyle from the West, consistent with the establishment of hard rules that are pro-market. In India, the anti-foreign culture, as a result of the long-time British rule, and the Hindu culture that repudiates material pleasure may have hindered the reform. Another aspect is that China was establishing market-oriented institutions from an institutional vacuum, which is relatively easier than India’s effort to incrementally improve existing market institutions. Contrary to the common belief, many of India’s market rules are better developed than China’s, such as the foreign exchange system and the rule of law.

These four elements, to a great extent, determine the pace of economic reform in the two countries. Furthermore, these elements do not act in isolation. They form the so-called “political economy” of a country. China achieved high economic development while maintaining a non-democratic political system and India seems to have gone down a different path.

Quest: It seems that there is an underlying theme of your study, that is, the interplay of the political system and the economic system. Dr. Chen, what does this tell us from the perspective of a political scientist?

Chen: The relationship between economic development and political democracy has been always a central yet perplexing question on the research agenda of social sci-

entists, especially political scientists. In the light of this relationship, the following questions have often drawn scholars’ attention: Does economic development necessarily prompt the emergence of political democracy or strengthen an existing democracy in a developing country? If so, do both economic development and the emergence or strengthening of political democracy come together at the same time? How does a democratic political system affect economic development in a developing country? Although many scholars have tried to answer these important questions, there has been no consensus among them. As mentioned earlier, while both India and China have experienced unprecedented economic development – though at variable paces – that resulted from their recent economic reforms, the two countries have different political systems. We believe our comparison of India and China not only sheds light on the key theoretical questions about the relationship between economic development and political democracy, but also provides plausible predictions of the political effects of economic development in both countries.

Quest: What are the political ramifications of the economic reforms in China?

Nair: In terms of the effect of economic development on political change, our study shows that economic development will promote a political democratization in China in a top-down manner, even though the political democratization there has so far lagged behind economic development. Moreover, we believe that the economic reforms result in political changes mainly through new institutions, both formal and informal, that are established by the reforms.

Quest: Perhaps a more intriguing issue is how China and India’s political systems affect their economic development.

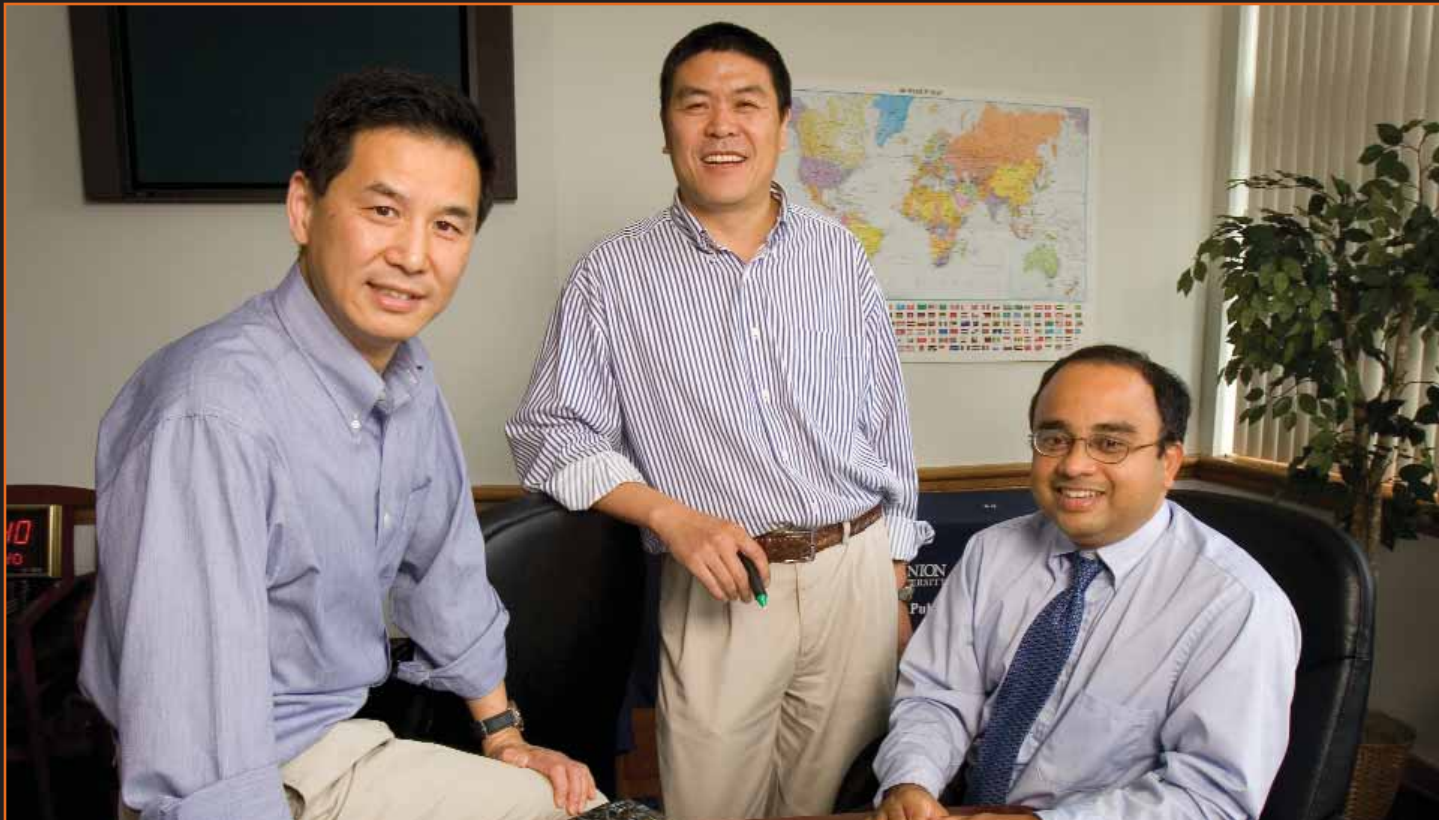
Chen: This is a very important question for both China and India. As for the impact of political democracy on economic development, the findings from our study suggest that a democratic system in a developing country is less efficient than an authoritarian system in initiating a major economic reform that could lead to high-speed economic development. This is because in a democracy such as India, a major policy to initiate economic reform is often constrained and dragged by multiple sociopolitical forces. In an authoritarian society such as China, this kind of policy is often made swiftly by a small group of political leaders who are not constrained directly by the public. Yet, after the initial stage of economic reform, a democratic system tends to have a more positive and

lasting effect on economic development than an authoritarian system, since the former is more likely to encourage, protect and institutionalize free competition and property rights. These findings explain why, in the early stage of economic reform, India is behind China, and it is quite likely that India will be ahead of China in the long run unless there is a major change in the nature of each country's political system.

Quest: You have provided some thoughtful insights about economic reforms in these countries, and with regard to their different experiences, the story of the tortoise and the hare comes to mind. Is there a comparison to be made here?

Li: This is an interesting, but tricky, metaphor. As always, reality rarely conforms to popular folklore. We find that China has been racing ahead like a hare without frequently taking naps, while India, on the other hand, has been lumbering ahead like a tortoise, taking frequent pauses because of the inherent delays in building consensus in a democratic system. However, China's fast economic pace has suffered major setbacks, due to political crises such as the 1989 Tiananmen Square

demonstration. We believe the gap between the political structure and economic development will generate punctuations or pauses in the future in China. Because India's political system is aligned with its economic policies, it should continue to lumber on without major pauses. Yet, we qualify our observation by noting Yogi Berra's dictum that "prediction is difficult, especially about the future." The purpose of our study is aimed more at understanding the relationship between the political and economic factors and their interplay in economic reform, than of predicting the exact pace of the reforms in the two countries. Such an understanding will help policy makers and corporate executives in formulating their reform and business strategies.



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