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ROLE STÁTU V EKONOMICE A STÁTNÍ KAPITALISMUS: PŘÍPAD ČÍNY A INDIE

THE ROLE OF STATE IN THE ECONOMY AND STATE CAPITALISM: THE CASE OF CHINA AND INDIA

Martina Jiránková[1]*, Dominik Proch*[2]

Navzdory zdánlivé podobnosti vykazují ekonomiky Číny a Indie značně odlišnou struktury běžného a finančního účtu platební bilance. Cílem stati je detailněji zkoumat tyto dvě asijské ekonomiky právě z perspektivy bežného a finančního účtu, a to s ohledem na jejich vývoj a strukturu. Zatímco Čína je klasickým příkladem státního kapitalismu a čerpá výhod, jež zapojení do světové ekonomiky nabízí, Indie je v určité fázi přechodu od centrálně plánované k tržní ekonomice. Čína dlouhobobě vykazovala vysoké přebytky běžného účtu, tento trend se však postupně mění za probíhající reorientace k domácí poptávce. Vývoj indické platební bilance naopak indikuje relativně nízké zapojení ekonomiky do globálních reálných i finančních toků.[3]
Klíčová slova: státní kapitalismus, Čína, Indie, platební bilance

Despite the apparent similarity of China and India, a very different structure of their current and financial account has been found out. The purpose of the article is to examine these two economies from the perspective of current and financial accounts in more detail. China is a classic example of state capitalism but also it can use advantages which the global economy is offering. India is somewhere in the transition from a centrally planned economy to a market economy. China has shown high surpluses of its current account for a long time. This trend is gradually changing and China is reoriented to the domestic consumption. The balance of payments' development in India indicates relatively low involvement of the economy in both real and financial flows.

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Key words: state capitalism, China, India, balance of payments
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1 INTRODUCTION

International Political Economy aims to study the relationship between states and markets, i.e. the relationship between policy and economy. This relationship has resulted in different models of capitalism in various countries, depending on a number of historical, cultural, religious and other factors. The model of a liberal state (US), a developing state (Japan) and a welfare state (Germany)[4] are being discussed, but there are other classifications at the same time. Similarly, there is often discussion about the role of the state in globalization processes, whether it is diminishing in the context of the establishment of other powerful actors aspiring to a normative role in the globalized economy (regional clusters, financial markets, multinationals, etc.), or vice versa, whether the role of the state is increasing, since the state can help increase the efficiency of economic entities located on its territory (support for science and research, provision of physical infrastructure, reduction of taxation of economic entities, provision of social consensus, etc.).

State intervention in the economy has been historically significant in China and India, and remains so. The purpose of this article is to examine these economies from the perspective of current and financial accounts in more detail, since both economies exist and naturally operate in the context of international economic relations. The possibility to use the global economy is a great challenge and an opportunity for both countries. The analysis is conducted about a similarity which could appear at first glance in the case of these two most populous Asian economies. While China's system is a classic example of state capitalism built intentionally by the country (Bejkovsky 2016), India is somewhere in the transition from a centrally planned economy to a market economy, still with very strong elements of state intervention in the economy (Bremmer 2014, p. 109).

Both China and India are still considered to be those of the most prospective economies. According to the IMF (2017a), using the GDP indicator in purchasing power parity (PPP), they are already the largest Asian economies, or the first and third largest economies in the world respectively, which have been evincing double-digit growth rates recently. Already by 2001, Goldman Sachs, headed by Jim O'Neil, integrated both countries (together with Brazil and Russia) into the de facto artificially formed group of economies with the most promising development in the first half of the 21st century, for which the BRIC acronym was established. At the same time, they are also significantly influencing the development (and parallel shape) of the world

[4] Classification by Gilpin (2011).

financial and monetary system, which is evident from the participation of these countries in the establishment of institutions such as the New Development Bank (NDB) or the Asian Infrastructure Investment Bank (AIIB).

2 STATE CAPITALISM

State capitalism is an important phenomenon of the contemporary world. It is a system where the state dominates markets seeking primarily political gain (Bremmer 2014). The American Chamber of Commerce (2013, State Capitalism, paragraph 1) defines state capitalism as an „increasingly common tool for managing economic development, giving rise to state-owned companies and, in some cases, privately owned companies that retain close political influence and financial ties to their governments". The primary objective of this system is thus maintaining and strengthening political power at home and abroad, more than the effectiveness of economic transactions and market freedom.

State-capitalist systems are generally associated with countries such as China, Russia, Brazil, Saudi Arabia, United Arab Emirates (UAE), Egypt, Algeria, Ukraine, India, Mexico and other countries. According to CIA (2018) statistics, more than 3.35 billion people lived in these countries in the middle of 2017, which is almost half of the world population. The list of countries shows that they are very heterogeneous and, in case we would like to classify them, can be divided into large economies (China, Russia, India, Brazil) and small economies (UAE and Saudi Arabia); or economies based predominantly on extraction of raw materials, such as oil or natural gas (Russia, UAE and Saudi Arabia), and economies based on industry and production (China). According to the Democracy Index (2017), considering the total ranking of 167 countries, regimes in these countries are mostly classified as authoritarian (Russia 134th, Egypt 133rd, China 136th, UAE 147th and Saudi Arabia 159th), while other states, such as India (32nd), Brazil (51st) and Mexico (67th), are among „flawed democracies".

State capitalism manifests through various instruments (Bremmer, 2014): ownership of oil and gas companies in the countries that extract these raw materials, foreign expansion in the name of securing raw materials in the spirit of so-called raw materialism, and state ownership of enterprises which are not engaged in raw materials extraction – financial institutions or companies in the automotive industry and others (e.g. China Development Bank or Dongfeng Motor Corporation). Another significant manifestation of state capitalism is the existence of sovereign funds, which are investment funds owned by states and which accumulate financial assets in foreign currencies in the form of shares, bonds, real estate, etc. At the beginning of 2018, the total amount concentrated in these funds amounted to approximately USD 7.58 trillion (SWFI, 2018) – for comparison – at the end of 2012, the total value of sovereign

wealth assets amounted to USD 5 trillion (Jiránková – Žamberský 2014). The largest fund in terms of assets in 2018 was the Norwegian Government Pension Fund Global, which administered USD 998.93 billion, followed by the sovereign funds of the UAE, China, Saudi Arabia, Kuwait, Qatar, Singapore and other countries (SWFI 2018).

There is one aspect which is equally attributed to state capitalism and that is its pragmatism: unlike centrally planned economies that have been primarily concerned with ideology; the current systems of state capitalism, including the Chinese, where the Communist Party is in power, maintain the existence of the private sector. At the same time, some sectors are either owned by the state or „only" governed, and economies are deeply rooted in the global political and economic order (McNally 2010). In contrast to the relative isolation of centrally planned economies (compared to market economies) that used to exist in the past, state capitalist regimes use all the benefits of the multilateral trading system (WTO membership), they are more or less open to investment and capital flows, and thus the influx of innovation, they also own financial assets that are globally allocated (sovereign funds), etc. Table 1 shows some indicators of economic "integration" of selected countries into the outside world.

Tab. 1: Economic „integration" of countries into the outside world, selected indicators

	Export + import/ GDP (% GDP)	***Net FDI inflow (% GDP)***	***Net migration rate per 1,000 inhabitants 2010/2015 (%)***	***Internet users (% population) 2014***
Russia	50.7	0.5	1.6	73.4
Brazil	27.4	4.2	0.0	59.1
Ukraine	107.5	3.4	0.9	49.3
China	41.2	2.3	-0.3	50.3
Egypt	34.9	2.1	-0.5	35.9
India	48.8	2.1	-0.4	26.0
UAE	175.9	3.0	9.3	91.2
Saudi Arabia	72.5	1.3	5.7	69.6
Algeria	62.5	- 0.2	-0.8	38.2
Mexico	72.8	2.6	-0.9	57.4

Source: UNDP, 2016

Regarding sovereign funds, there are concerns about investments of these funds in the case of entry into strategic sectors such as defense, energy, transport networks, ports, telecommunications and others (Jiránková 2012), since the security of such countries may be compromised. However, it does not have to be just strategic sectors. For example, purchases of equity interests in banks and other financial

institutions in the US and UK – in Citygroup[5], Merrill Lynch, Morgen Stanley[6], Barclays PLC, UBS, and Credit Swiss (UNCTAD 2009, SWFI 2008), led to their rescue at the time of the financial and economic crisis, but at the same time, these funds and their countries have the potential of destabilizing these institutions, for example by sudden mass sales, and thus by lowering the value of their shares. The purpose of this step can be both economic and political.

The fact that these economies are embedded in the existing global environment by their external ties gives these countries a number of advantages, but at the same time, the system of state capitalism is to a certain extent determined by these links together with other factors. An example is the dependence of state-capitalist regimes, such as Russia, the UAE and Saudi Arabia, on the price development of exported raw materials on world markets, or the dependence of export-oriented economies, such as China, on the development of consumer demand in advanced market economies (especially in the US and the European Union), or the economic dependence of the US and China, etc. Not being standard advanced market economies, these economies are not set to be adequately and flexibly responsive to ongoing changes and movements in the global economy: this would be possible in the case of some more developed and functioning commodity and capital markets, flexible exchange rates, standard banking systems, etc. State capitalism is thus able to concentrate resources more easily, but it can no longer awaken the creativity of economic subjects and allocate scarce resources as efficiently and effectively as in market conditions. The decisive role of the state is also related to other negative phenomena, such as high levels of corruption, clientelism, etc. China and India are joint-ranked 79th out of the 176 monitored countries in the Corruption Perceptions Index in 2016 (Transparency International 2017).

In the contemporary world, China is a typical representative of state capitalism. After years of limited foreign contacts, in 1978, the country switched to reforms of its economic system and to a strategy of opening up to the world: on the east coast, special economic zones were established, which should originally have served for Chinese export of goods, evinced low customs and tax duties and allowed foreign investors to enter the Chinese market; generally, China has explored the possibility of using market features through these special economic zones. The Chinese economy is based on relatively diversified production. In the economy, state-owned enterprises, such as China Mobile, Sinochem, State Grid, Chinalco, China National Petroleum, Sinopec and others, play an important part. The last two mentioned entities should operate internationally and supply oil and gas resources from abroad for the country's future development in the spirit of raw material nationalism. Some state-

[5] Abu Dhabi Investment Authority acquired 4.9% stake in this bank (SWFI 2008).
[6] China Investment Corporation acquired 9.9% stake in this institution (SWFI 2008).

owned enterprises come under central government, others are under local governments. In addition to engagement in state-owned enterprises, these companies are also subsidized by the state, which naturally makes them more competitive compared to domestic private competition and competition abroad. The state is also engaged in the banking sector and has founded the sovereign funds of China Investment Corporation (CIC) and State Administration of Foreign Exchange (SAFE). The first fund's assets amounted to USD 900 billion at the beginning of 2018, and approximately USD 441 billion in the case of the second one (SWFI, 2018). Funds are raised through the pro-export orientation of the Chinese economy and the high surpluses of the Chinese current account (or the exchange rate regime respectively), which led to an accumulation of foreign exchange reserves (amounted to USD 3.3 trillion in June 2016). As Bremmer (2014, p. 126) states, „the leadership of the Chinese Communist Party believes that, to justify its monopoly of political power in the state, it has to create millions of jobs each year". It is simply the pursuit of growth and employment, and so avoiding social upheavals, which has stood in the background of Chinese pro-export orientation, which was supposed to substitute weak domestic demand. The other side of this coin is the dependence of Chinese exports on economic development, especially in the US, the EU, and Japan.

Since its proclamation of independence in 1947, India applied a centrally planned system, operated by the Indian Planning Commission, until 1991. There were state-owned enterprises in the country, and there was also an effort to protect domestic businesses against foreign competitors by means of both tariff and non-tariff instruments (for example, tariffs in the automotive industry reached 100-200% by the 1990s), significant restrictions on the entry of foreign investors, and the strategy of import substitution in industry, leading to a further reduction in economic ties with foreign countries. Since 1991, the country has switched to a strategy of opening up to the world, indicative planning, deregulation, and the possibility of foreign capital. However, five-year plans are still in place in the economy and the state is engaged in the production of food, fuel, fertilizer, electricity and water; state-owned enterprises are competing with private entities in the petrochemical and gas industry, aeronautics, energy, metalworking, and defense. In India, there are 200 state-owned companies, while half of the 40 largest companies in the economy are state-owned (Bremmer, 2014).

According to Forbes 2017 ranking, 15 Chinese enterprises (including 1st, 2nd, 6th and 8th place for Chinese banks) and no Indian company ranked among the TOP 100 largest public companies in the world (the Reliance Industries company conducting research, production and processing of gas and oil wes placed 106th) (Forbes, 2018). India has no sovereign fund – although, due to the size of the economy,

oil and minerals naturally play an important role in economic processes and trade flows (but especially from the import perspective – see below).

3 METHODOLOGY

Following empirical part has a form of comparative study. As mentioned already in the introduction, China's and India's positions in the system of international economic relations are analyzed, compared and evaluated, with a focus on the role of the state in the economy and in interaction with foreign entities. In this respect, selected instruments are closely researched, such as a role of trade, its structure and balance (on goods and services), stocks and flows of foreign direct investment, exchange rate regime, level of protectionism, domestic savings and investment, state budget, etc. Authors use an inductive approach by examining individual aspects of external as well as internal economic processes so that generalizing conclusions can be drawn.

Based on introduction of the phenomenon of state capitalism and the role of the state in the economy, specifics and development of individual accounts of the balance of payments are analyzed by using an example of China and India. So that relevant data could be compared, datasets of international (economic) organizations are used as an input for further analysis (due to their unified methodology in terms of data collection, calculation, etc.). In the case of balance of payments' structure and development, database of International Monetary Fund (IMF), namely International Financial Statistics, is chosen as a reliable data source, supplemented by World Development Outlook Database published also by the IMF. Regarding related trade and investment exchange, the data are derived from World Development Indicators database managed by the World Bank as well as statistics database of the World Trade Organization (WTO), World Investment Report published by the United Nations Conference on Trade and Development (UNCTAD), datasets and outcomes of surveys conducted by the Organization for Economic Co-operation and Development (OECD), and others.

Since the balance of payments represents systematical and statistical statement of all economic transactions between residents and nonresidents of a specific country during a particular time period, authors use this prism to assess involvement of the analyzed countries in the world (globalized) economy, or to assess their ability to benefit from this involvement respectively. In order to comply with currently available data, the structure of balance of payments is considered according to the Sixth Edition of the IMF's Balance of Payments and International Investment Position Manual (BPM6)[7] as displayed in Figure 1.

[7] Besides others, one of the difference important for statistical appraisal resides in introduction of concept „net acqusition of financial assets" and „net incurrence of liabilities" instead of

Fig. 1: Overview of balance of payments' structure according to BPM6

Balance of payments			
Current account	Credits	Debits	Balance
Goods and services			
Primary income			
Secondary income			
Capital account			
Net lending (+) / net borrowing (–) (from current and capital accounts)			
Financial account	Net acquisition of financial assets	Net incurrence of liabilities	Balance
Direct investment			
Portfolio investment			
Financial derivatives			
Other investment			
Reserve assets			
Net lending (+) / net borrowing (–) (from financial account)			
Net errors and omissions			

Source: IMF, 2013

Given their significance in terms of a country's involvement in the system of international economic relations, mainly current account and financial account of the balance of payments are emphasized in this paper.

4 China and India on the current and financial accounts of the balance of payments

Table 2 already shows the diametrically different position of the two countries in the system of international economic relations. A high surplus of balance on goods and a high deficit of balance on services is shown in the case of China, and vice versa for India. Both countries offer a higher outflow of returns on foreign direct investment (FDI) placed on their territories compared to the inflow of returns on the domestic investment placed abroad. China is still partly able to offset this phenomena by income from residents working abroad. China's current account was constantly in surpluses (Figure 2) between 2007 and 2016, although this surplus declined, and amounted to half the value in 2016 in comparison to 2008. High current account surpluses culminated in 2007 when the surplus amounted to 10.1% (OECD 2017a). In connection with the use of a fixed exchange rate, these surpluses have also led to an

„credits an debits" in terms of the financial account. Currently, a positive sign indicates an increase in assets or liabilities, and a negative sign indicates a decrease in assets or liabilities.

increase in foreign exchange reserves, which have become a pool of resources for the Chinese sovereign fund, SAFE. Due to the fact that 18.3% of Chinese exports are directed to the US, the undervalued exchange rate against the USD is a source of cautious criticism. India, by contrast, has used a floating exchange rate regime, namely in its controlled form since 2000, i.e. without a central parity or oscillation band, while allowing interventions of the central bank.[8]

Tab. 2: Current account structure in 2016 (million USD)

	China	***India***
Current account	196,380.0	- 12,113.7
Balance on trade in goods	494,077.0	- 107,475.5
Balance on trade in services	- 244,163.0	65,896.4
Balance on primary income	- 44,013.0	- 27,361.2
Balance on income from FDI	- 65,032.0	- 34,442.7
Balance on workers' income	20,672.0	1,212.0

Source: IMF, 2018

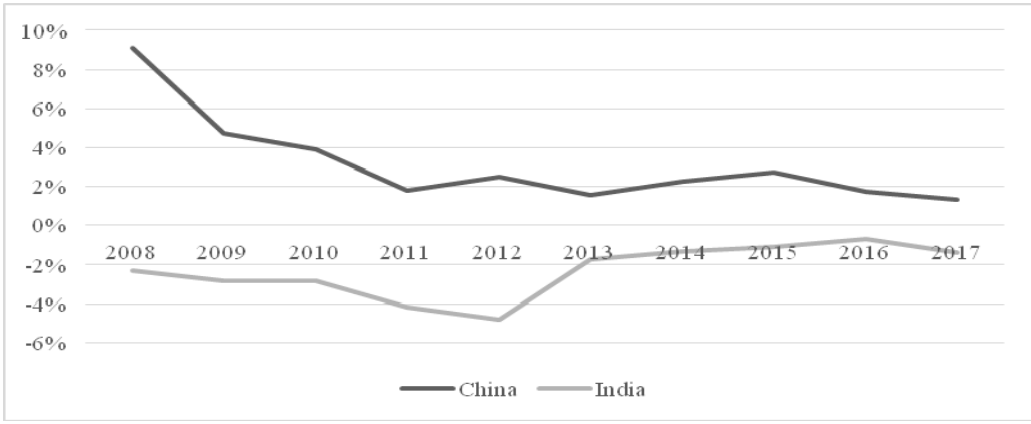
In terms of role of trade and according to WTO (2018a) statistics, India takes 20th place among the world's largest exporters of goods, and 14th place in terms of import[9] respectively. China is the largest exporter and second largest importer[10] of goods in the world (WTO 2018a), which is fully in line with common knowledge and from the figures' obvious export-oriented approach of the Chinese economy as opposed to the Indian economy, which is more import-oriented, also in relation to the role of consumption in India as the most important component in aggregate demand (India's share of world imports was 2.21% in 2016, China's was 9.78% and the US had 13.88%).

[8] However, some authors (Shah and Patnaik 2011) denote the rupee as a currency de facto hung on the US dollar as most of the central bank's intervention purchases and sales on the foreign exchange markets are linked to the world's most important reserve currency.

[9] If we consider the EU as one economic entity, India would rank as the 14th largest exporter and the 9th largest importer in the world.

[10] If we consider the EU as one economic entity, China would rank as the third largest importer in the world.

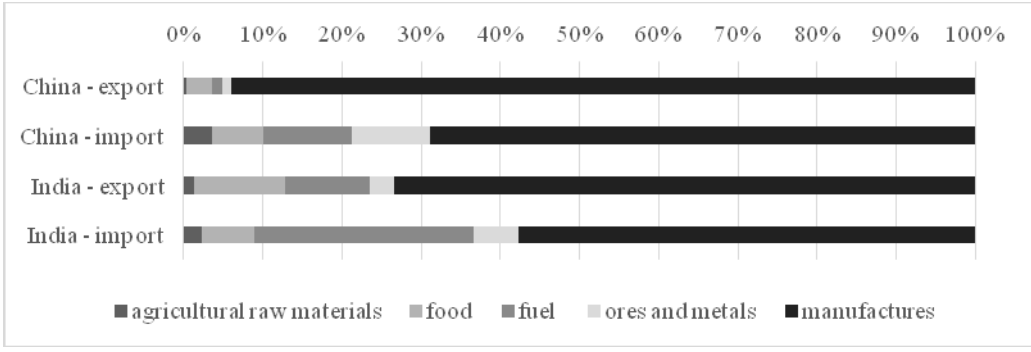
Fig. 2: Current account development – China and India (% GDP)



Source: IMF, 2017d

In direct comparison, India is also a significantly less industrialized country. While manufactured products account for around 95% of Chinese exports, it is only 73% in the case of India (see Figure 3). China, as the world's number one exporter, accounted for 13.15% of world exports in 2016 (US 9.12% and India 1.65%) and its main export commodities are machinery products, such as automatic data-processing machines, radio-telephony transmission tools, line telephony electrical apparatus, electronic integrated circuits, etc. Electronic integrated circuits, oil and iron ore dominate then on the import side (WTO 2018a).

Fig. 3: Trade structure by commodity in 2016

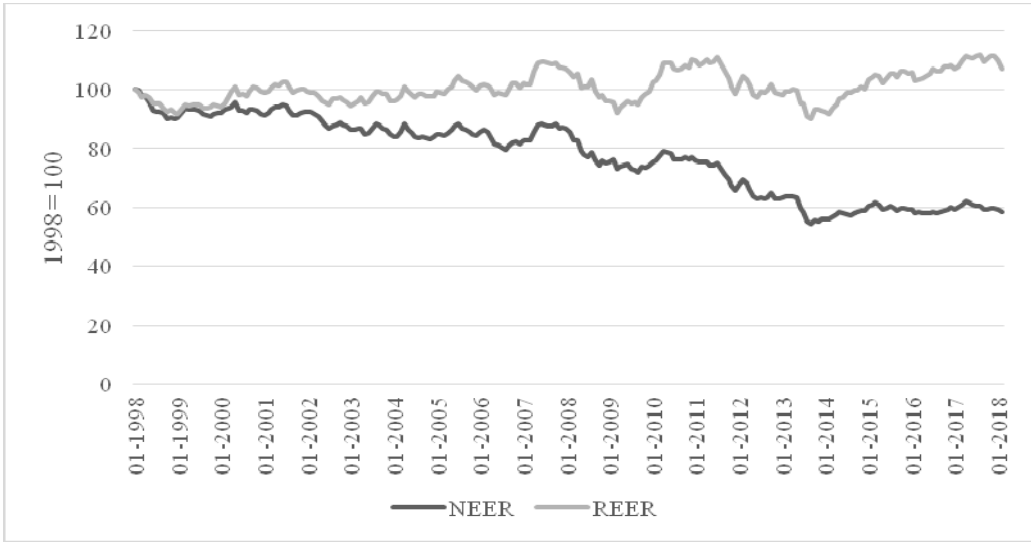


Source: WB, 2018

An important role in Indian foreign trade is played by fuels and minerals, which account for a third of total imports, with petrochemical products being the most important single item on the export side as well. India is a net importer of fuels, and oil imports are highly reflected in the current account deficit. Between 2006 and 2014,

crude oil accounted for 20-28% of total Indian imports, followed by non-monetary gold, pearls, precious stones and semi-precious stones, coal, and natural gas. Only telecommunication equipment and fertilizers protrude from fossils, raw materials and commodities. Between 2015 and 2016, crude oil evinced a share of 17.7%, or 16.7% respectively (UNCTAD 2017). The drop-in oil prices and restrictions on gold imports have significantly contributed to the diminishing current account deficit (see Figure 2). The high demand for gold (gold imports) was to a certain extent caused by the negative real interest rate, so economic subjects preferred gold instead of financial savings (this also has a historical background). Indian exports are composed of commodities from the primary sector to energy, machinery and transport, and the country has been successful in integrating into global value chains too. Since 2000, Indian exports have been steadily improving by up to a fifth annually, but have fallen due to the decline in foreign demand since 2008 (influenced by the financial crisis), real appreciation of the Indian currency and high customs duties (see below) (IMF 2017c).

Fig. 4: Long-term development of nominal (NEER) and real (REER) effective exchange rate of Indian currency



Note: indirect quote (higher value = appreciation), monthly averages, REER (CPI), own calculations.
Source: BIS, 2018

Moderate real appreciation has occurred in spite of the long-term nominal depreciation of the rupee, but in line with inflationary pressures triggered by the central bank's (partially sterilized) interventions on the foreign exchange markets (in particular application of the US dollar sales and purchases) which neutralize

development at nominal level, or contribute to real appreciation respectively (from a long-term perspective, it is rather a stable development of the real exchange rate) (Durčáková – Šíma 2015). This split is illustrated by the development of the nominal and real effective exchange rates of the Indian currency – see Figure 4. It can be concluded that the (positively) diminishing deficit of the current account is not due to exchange rate changes, or more precisely, the constant development of the real exchange rate is not a prerequisite for the increasing competitiveness of Indian production abroad.

Regarding the territorial structure, India's trade is well diversified. Over a long period, the EU has been India's most important trading partner, while also being the most important destination for Indian exports and the second largest source of Indian imports. In total, the EU is at the top, exceeding China as well as the US. With respect to the commodity structure and its effects on the current account, Arab states of the Persian Gulf are non-negligible trade partners, in particular the UAE or Saudi Arabia. In 2016, the UAE (assuming the EU as one entity) accounted for 11% of Indian exports, and together with Saudi Arabia reached roughly the same level in imports (each country with a 5.0-5.5% share) (WTO 2018a).

China's largest trading partners (from the perspective of Chinese exports) are predominantly the advanced market economies of the US (18.3% of total exports), the EU-28 (16.1%), Hong Kong (13.8%)[11] and Japan (6,1%), which fully corresponds with the commodity structure of Chinese exports based on the more sophisticated manufacturing products directed at the advanced economies. The structure of imports by territory follows accordingly: EU-28 (13.1%), Korea (10%), Japan (9,2%), Taiwan (8.8%) and USA (8.5%) (WTO 2018a). A higher level of advancement of the Chinese economy and gradual orientation towards domestic consumption is evident from the growing demand for high-tech goods also in Chinese imports, from around 20% to 55% over the past twenty years; on the other hand, demand for low-tech goods fell from 25% below 10% (OECD 2017a). The more favorable composition of Chinese exports is also due to the fact that the country has captured the trend of shaping global value chains. First, it became integrated into the lower stages, later also took part at higher stages of the manufacturing process, and currently is the leader in South and Southeast Asia. In this respect, an elaborate industrial policy has also been complemented by state investment in infrastructure.

Both countries are WTO members (India since 1995, China since 2001). Table 3 illustrates the average customs duties of individual commodity groups in China and India. It shows a much higher burden on imports in India than in China, especially in the agriculture and food sector, but also in industry, indicating relatively strong

[11] Hong Kong serves for further reexports of Chinese goods.

protectionism, although on the basis of OECD (2018) statistical data, it can be argued that the Indian economy is gradually opening up: value added produced abroad and imported back has been around a third of the value of Chinese exports over the last 20 years; on the contrary, there was a strong dynamic in Indian exports – from 9.5% in 1995 to the current one quarter.

Tab. 3: Average customs duties of commodity groups (%)

	China	*India*		*China*	*India*
Animal products	14,9	106,1	**Minerals and metals**	8,0	38,3
Dairy products	12,2	65,0	**Crude oil**	5,0	-
Fruit, vegetables, herbs	14,8	100,0	**Chemicals**	6,7	39,6
Coffee, tea	14,9	133,1	**Wood, paper**	5,0	36,4
Cereals	23,7	115,3	**Textiles**	9,8	27,1
Oil seeds, fats, oils	11,1	169,7	**Clothes**	16,1	37,4
Sugars and sweets	27,4	124,7	**Leather, footwear**	13,7	34,6
Spirits, tobacco	23,2	120,5	**Non-electrical engineering**	8,4	28,6
Cotton	22,0	110,0	**Electrical engineering**	8,9	27,8
Other agricultural products	12,1	104,8	**Transport equipment**	11,4	35,7
Fish products and byproducts	11,0	100,7	**Manufactures**	12,2	34,0

Source: WTO, 2018b

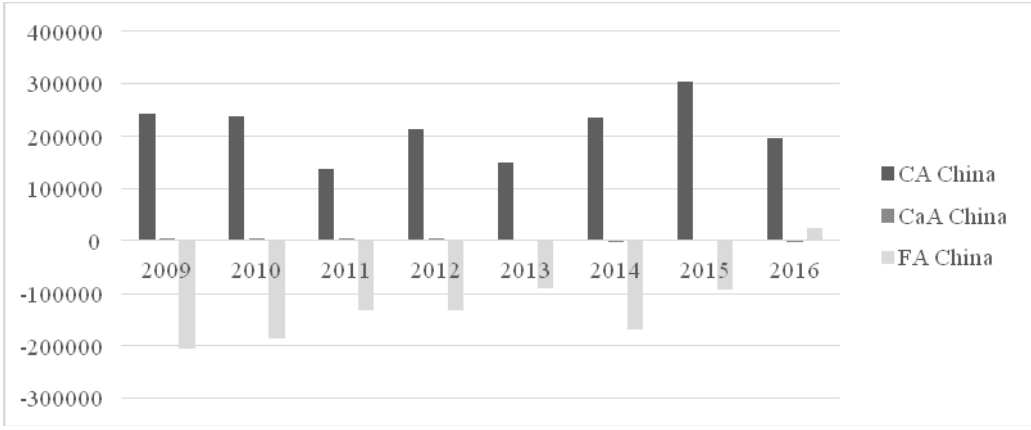
India is globally more significant player in the field of services, holding the position of the 5th largest exporter and 6th largest importer (WTO 2018a).[12] The beginning of this trend can be noticed as far back as in the 1980s, when the development of the entire tertiary sector was initiated, with further acceleration in the 1990s. In the first decade of the new millennium, the service sector showed more than 9% growth. Knowledge-oriented and higher added value categories (i.e. software, communications, or financial services) are at the forefront. Currently, the IT sector accounts for 7.7% of Indian GDP and represents the third largest IT market (exceeded by the US and the EU). In particular, the software industry is the largest contributor to the positive balance on services, which India has consistently achieved since 2004 – unlike the balance on goods (RBI 2017). India's success in delivering IT services has

[12] This position is valid considering the EU as one economic entity.

been strongly influenced by targeted state policy (related education programs or targeted partnerships with the private sector), supported by the comparatively higher level of English knowledge of the Indian population.

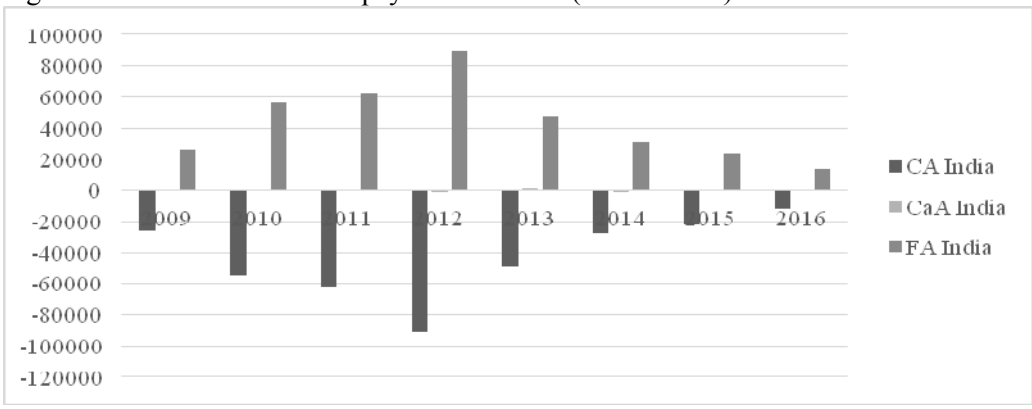
Contrary to the development of the balance on services in India, looking at statistics, the country's current account deficit in the period 2010-2013 is obvious, with an alarming deficit of 5% of GDP in 2012, after which the current account deficit has diminished (Figure 2). Excluding the inelastic demand for oil and gold imports, this phenomenon was significantly affected by the state of the domestic economy. The Indian economy has been paralyzed by the escalation of strong regulation, weak growth in industrial production, excessive state apparatus, including inefficient state-owned enterprises (SOEs), and a high inflation rate (over 10%) or problems of public finances (OECD 2014). These problems have plagued the Indian economy since the second half of the 20th century, with initial major efforts to eliminate them dating back to the 1990s, when former Finance Minister Manmohan Singh initiated fiscal stabilization, deregulation and liberalization of the economy, support for science, research, technology and the tertiary sector (in particular telecommunications and IT) or privatization of most economic sectors except those with increased state interest (Joshi – Little 1996).

Fig. 5: Structure of balance of payments – China (billion USD)



Source: IMF, 2018

Fig. 6: Structure of balance of payments – India (billion USD)



Source: IMF, 2018

China's financial account was practically closed before 2002. Between 2008 and 2016, there were steady outflows of capital with a declining tendency, and even with net inflows in 2016. Under the financial account, both direct and portfolio investment have evinced permanent outflows, with other investments showing the same development, with the exception of the years 2012 and 2014 to 2016. Foreign reserves steadily increased until 2014, then declined significantly between 2015 and 2016 and, according to IMF (2016) data, amounted to approximately USD 3,3 trillion in 2016. On the other hand, India's current account was permanently in deficit between 2008 and 2016 and also the financial account has reflected persistently low inflows of capital (liabilities) that all the sub-components of the financial account contributed to. The foreign exchange reserves then grew slightly.

Tab. 4: Index of restrictions on FDI in 2016

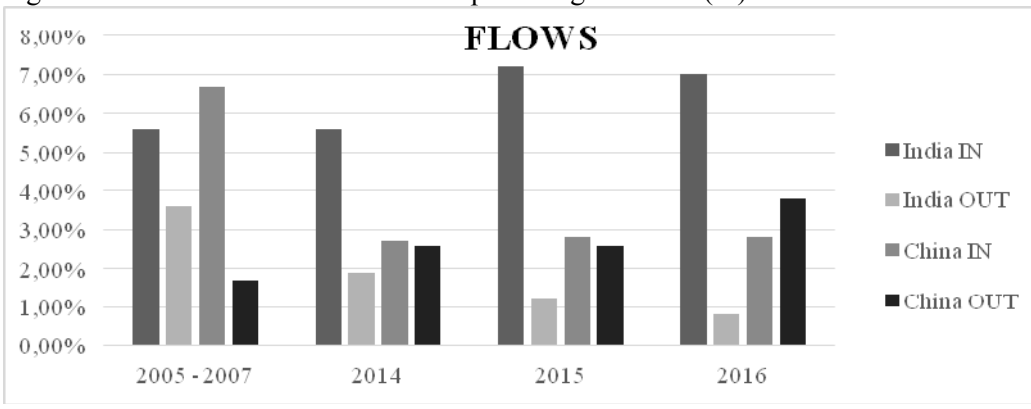
	China	***India***
Primary sector	0.373	0.213
Production	0.117	0.035
Electricity	0.440	0.064
Electricity distribution	0.650	0.000
Transport	0.538	0.093
Media	1.000	0.280
Communication	0.750	0.175
Financial services	0.493	0.279
Trade services	0.250	0.563
Total	0.327	0.212

Note: 1 = maximum regulation, 0 = no regulation

Source: OECD, 2018

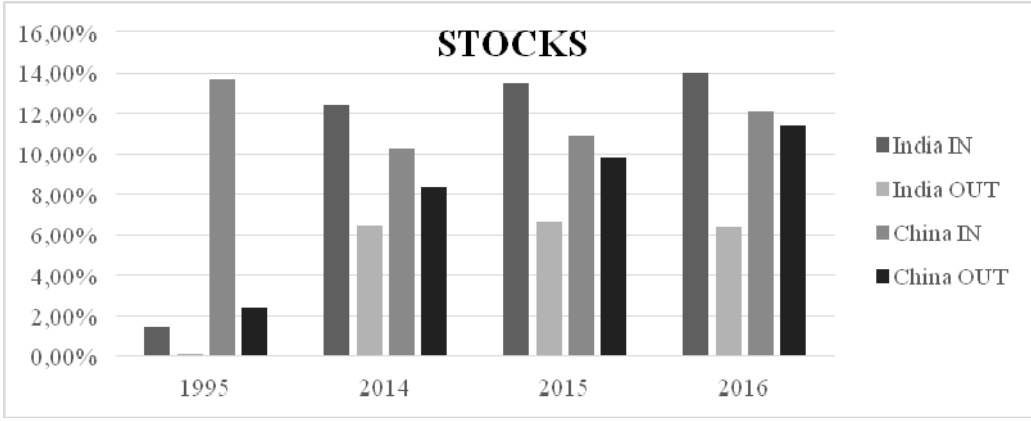
Table 4 illustrates the level of regulation for investors entering selected sectors in both countries. China evinces stronger regulation than India, especially in sensitive sectors such as media, communications, or distribution and electricity-related sectors. Yet, liberalization in the field of FDI is relatively high compared to portfolio investment and other investment. As stated by the IMF (2017a), outward investments have been liberalized since the 1990s in the context of the „Going Global 1999" strategy, as well as an effort to move the global value chains to higher levels of the production processes and to mitigate the appreciation pressures of the Chinese currency. Since 2012, the Foreign Investment Guidance Catalogue has been in place in China. It contains information for foreign investors on the possibility of their entry (segmentation of supported, limited and forbidden production sectors). The main emphasis is put on innovation and technological upgrading (China Briefing 2011).

Fig. 7: FDI flows of China and India as percentage of GDP (%)



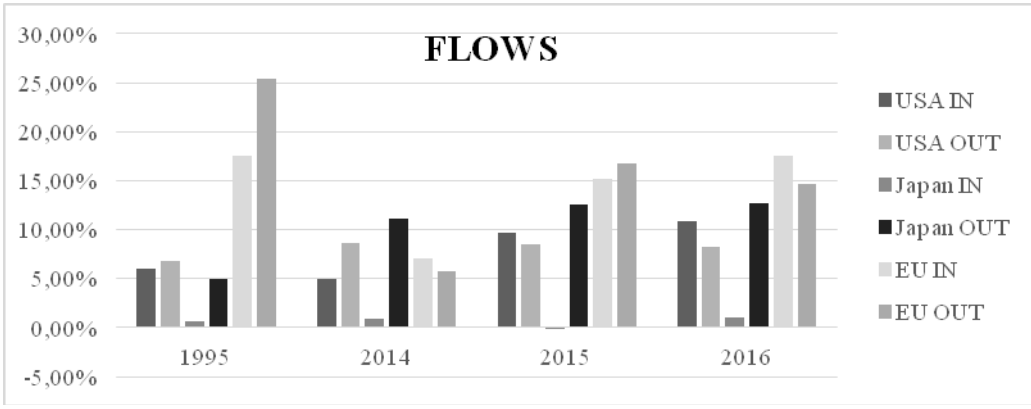
Source: UNCTAD, 2017

Fig. 8: FDI stocks of China and India as percentage of GDP (%)



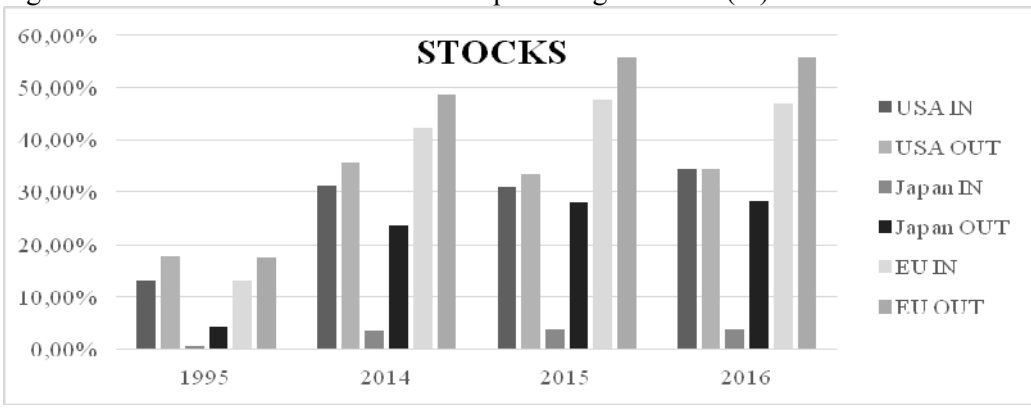
Source: UNCTAD, 2017

Fig. 9: FDI flows of selected entities as percentage of GDP (%)



Source: UNCTAD, 2017

Fig. 10: FDI stocks of selected entities as percentage of GDP (%)



Source: UNCTAD, 2017

Inward investment flows as percentage of gross capital formation were higher in India, and the same is valid also for stocks of these investments as percentage of gross capital formation, although figures in both countries are still multiply lower compared to the US or the EU, but higher than in Japan – as shown in Figures 7 to 10. As expected, outward investment of both countries is lower in both flows and stocks, which is typical sign of relatively less developed countries with a lack of equity. On the other hand, in developed countries, as can be seen in thecase of the USA, the EU and mostly Japan, outward flows and stocks as percentage of gross capital formation predominate. World Investment Report 2017 (UNCTAD 2017) shows an increase in FDI inflows in Shanghai, Fujian, Guangdong and Zhejiang free trade zones by 80%, amounting to USD 13 billion in 2016. From the beginning, these special economic

zones have served China as experimental areas for verification of intended reforms. The increase in FDI inflows is attributed to reforms at local as well as global levels.

Around 18% (257) of the total number of state-owned multinational enterprises in the world were headquartered in China and 4% (61) in India in 2017. There are 4 Chinese companies among the 25 largest non-financial state-owned multinational enterprises, and, in the case of financial enterprises, there are 4 Chinese companies out of the 10 largest in the world, including, at first place, the Industrial & Commercial Bank of China (UNCTAD 2017). These state-owned companies are instruments for outward expansion in the spirit of „Go Global", „One Belt, One Road", „Made in China 2025" or „RMB Internationalization".

Portfolio investment, or access to the Chinese stock exchange respectively, were liberalized in China for qualified foreign institutional investors in 2002 and this liberalization was extended to the interbank market between 2015 and 2016. Since 2007, domestic institutional investors have been able to invest globally, cross-border loans were released between 2008 and 2010, qualified domestic investors have been allowed to provide their branches abroad with loans since 2009, and these branches have been able to get loans themselves since 2010 (IMF 2017a). From the aforementioned list, it is clear that the liberalization of the financial account is taking place gradually. The IMF (2017b) recommends prudence and the implementation of supportive reforms in the form of an effective monetary policy, a healthy financial system and exchange rate flexibility for further liberalization of the financial account. China is currently using a managed exchange rate regime with a link to the basket of currencies, or tries to reduce the link to the US dollar towards the basket of currencies respectively.

India has also been implementing a gradual liberalization of the financial account of the balance of payments since the 1990s, while this account was closed for FDI inflows in the 1980s. In August 2017, the Indian Ministry of Industry and Trade issued a „Consolidated FDI Policy", which precisely defines sectors to which FDI may go with or without consent, sectoral limits[13], prohibited sectors (tobacco products and byproducts, lottery, nuclear energy production, the real estate sector), approval procedures, etc. (Ministry of Commerce and Industry 2017a).

[13] For example, foreign investors can automatically buy into insurance and pension companies up to 49% of the property value, up to 20% in the public banking sector with approval of the government, automatically up to 49% in the private banking sector and between 49% and 74% only with the consent of the government, etc. (Ministry of Commerce and Industry 2017a).

5 CONSUMPTION, INVESTMENT, GOVERNMENT REVENUE AND EXPENDITURE, CURRENT ACCOUNT

Current account development in both countries is determined by the relationship between consumption and investment, or state revenues and expenditures respectively. Elementary macroeconomic identity says that unnecessary spending is equal to leakage from the expenditure stream:

$$I + G + X = S + T + M, \quad (1)$$

after modification

$$(X - M) = (S - I) + (T - G), \quad (2)$$

where T represents net taxes.

Given the simplification of the current account to the difference between exports and imports (X–M), current account surplus is attributed to the positive difference between savings and investments (S>I), or the surplus of the state budget (T>G), or both. Also, vice versa, the current account deficit is due to the excess of investment over savings (S <I), or the deficit of the state budget, or both. A country with a current account surplus exports capital and in this way finances imports of a given business partner (own exports of goods and services), countries with current account deficits import capital to finance such imports.[14]

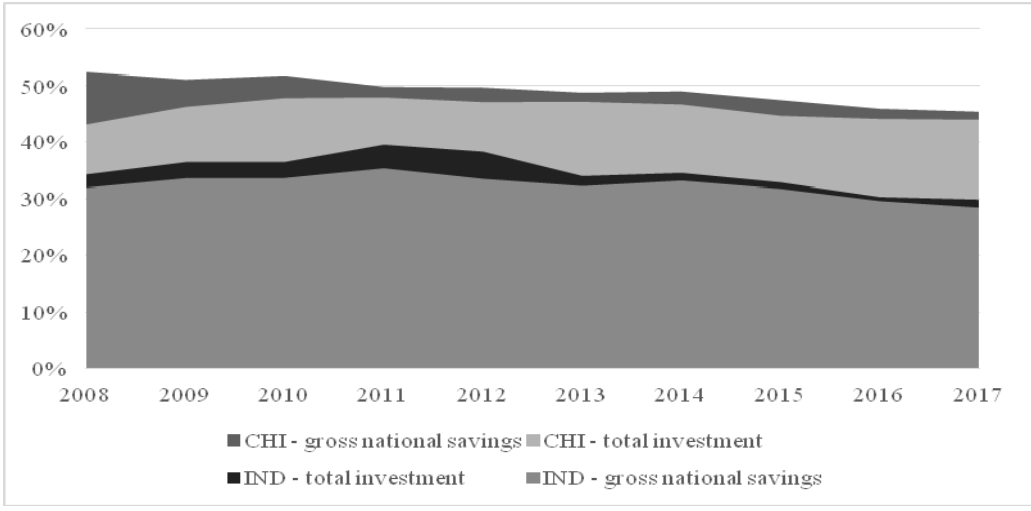
Figure 11 provides a look at the structure of gross national savings together with the total investment of China and India. For further analysis, one can notice the significant difference between the two countries, namely excess of savings over investment in China, and excess of investment over savings in India throughout the period under review.

High Chinese savings come primarily from households as a result of the one-child policy, lower social security, housing reform, and income inequality. It represents approximately 23% of GDP, which is a significant difference compared to the world average of 8% (IMF 2017a). Overall, high savings were first seen as a large current account surplus (see Figure 2 – years 2007-2008), and then, together with the current account surplus, they shifted towards high domestic investment, often with declining efficiency and rapid debt growth (IMF 2017a). In addition, high savings naturally reduce consumption in the country, unlike in India, where consumption is the key aggregate which most importantly contributes to GDP creation and which indicates import orientation to some extent. China itself has taken a number of steps to increase consumption (drop in interest rates, growth in social spending and progressive taxation, etc.), which has been reflected, for example, in the growth of imports and

[14] This is only valid if the state budget is balanced.

hence in the improvement of the current account, a decline in stocks, redirecting to domestic investment, etc. (IMF 2017b).

Fig. 11: Share of gross national savings and total investment in the country's GDP



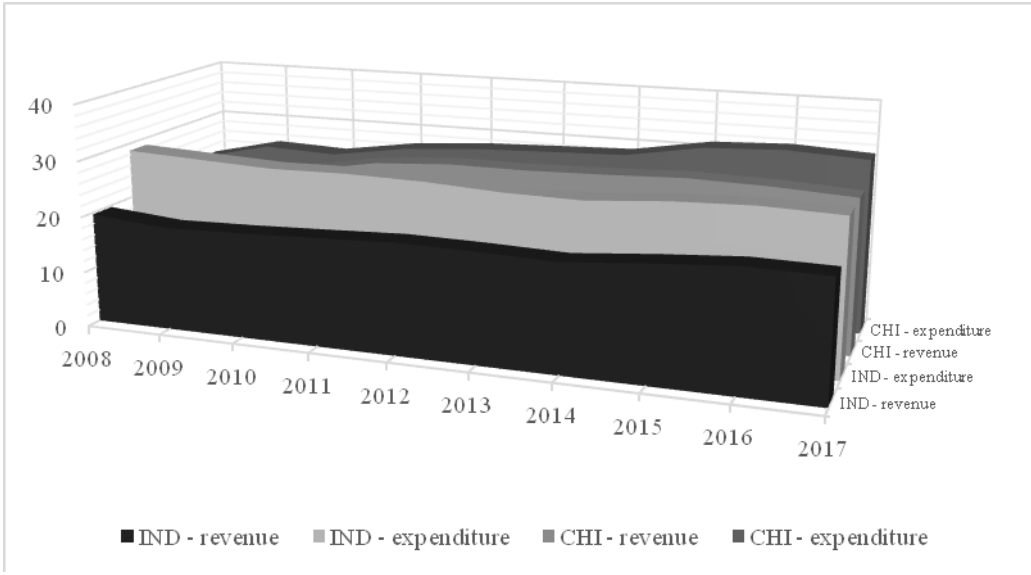
Source: IMF, 2017d

The overall level of Indian investment is under the Chinese level, yet, as stated by the OECD (2017b), there is potential for investment growth. Since 2007, however, investment rates have been steadily declining; households are the largest contributor to gross capital formation, fewer firms, and the lowest contribution comes from the public sector, which represents the potential for further growth of the previous two sectors. In this context, the OECD (2017b) recommends mainly public investment in energy and transport infrastructure (roads, railways, coal transport capacity, etc.). The next recommended step for public investment is to make electricity accessible to all and also to support private businesses (an ambitious plan by the Indian government promises this by 2019).

Figure 12 illustrates another determinant, namely the state budget, or its revenue and expenditure respectively. When comparing the two countries, it is obvious that both budgets must be deficit due to the excess of expenditure over revenue of the state budgets. It should be noted that these indicators are relative (to the country's GDP), so the figure does not offer a comparison of absolute values. Nevertheless, it is possible to observe that Chinese budget expenditure has been higher than Indian expenditure since 2012. While China is experiencing relative growth of this indicator and the gap between expenditure and revenue has been growing throughout the period under review, India evinces a significantly higher but stable relative difference. In 2008, the state budget of China ended up in a deficit of 0.41% of GDP, in 2016 the

deficit amounted to 3.8% of GDP (Trading Economics, 2018a), India successfully reduced the state budget deficit from an alarming 7.9% of GDP in 2009 to 3.5% of GDP in 2017 (Trading Economics, 2018b). These significant deficits also included subsidies to state-owned enterprises (Bremmer, 2014).

Fig. 12: Development of expenditure and revenue of state budgets – China and India (% GDP)



Source: IMF, 2017d

Considering the above-mentioned identity and based on excess of investment over savings and budget deficits, India should achieve a current account deficit with a related surplus on the financial account, which is also confirmed in reality. In the case of China, on the one hand, excess of savings over investment determines current account surplus, on the other hand, the long-term deficit of the state budget neutralizes this phenomenon. The final impact is illustrated in Figure 2, which shows the surplus of China's current account at about 1-3% of GDP between 2011 and 2017. The theoretically inferred Indian deficit is also confirmed graphically, oscillating at the level of 1% of GDP since 2013.[15]

[15] In IMF (2017d) data, the percentage difference between savings and investment is exactly equal to the current account balance as percentage of GDP. Budget deficit is thus included in savings as negative public savings, budget surplus as positive public savings.

6 STRATEGY IN EXTERNAL ECONOMIC RELATIONS FOR THE FUTURE

As evident from above, both countries are increasingly involved in the global economy. Since the special economic zones were established on the east coast of the country, China has benefited much more from this advantage. Even the name of the „Going Global" strategy is evidence. Its first stage was launched in 2000, and the second phase has been in progress since 2014. While the objective of the first stage was to find resources and offshore markets, the second phase is focused on science, innovation, services and consumption (China Policy 2017).

Tab. 5: Going Global strategy

Going Global 1.0	***Going Global 2.0***
solving resource security	ensuring return on investment
buying whole value chains	stimulating global demand
buying majority stakes	switching to portfolio investment
seeking local political patronage	avoiding dividing political elites
projecting China Model	blending with local operators

Source: China Policy, 2017

Together with this strategy, a ten-year strategy for industry called „Made in China 2025" was adopted in 2015, which aims to make China the leading country in the manufacturing industry. This strategy reinvigorates central state management, declares the intensification of a preferential policy for domestic firms against foreign entities and their financial support in selected sectors, and intends to create not only national but also global champions. Selected industries include IT, robotics, numerically controlled machines, space and aviation technologies, ship engineering, advanced railway technologies, energy saving equipment, new materials, biomedicine and agricultural engineering (U.S. Chamber of Commerce 2017).

An important part is the Belt and Road Initiative, which includes the Silk Road Economic Belt and the Maritime Silk Road, both being aimed at the development of economic activities from the east coast to the inland and west, also linking infrastructure, business, investment and human ties to Eurasia (China Policy 2017).

Current development in India is largely influenced by the policy of the new Indian Prime Minister, Narendra Modi, who was appointed to the office in 2014, and who has initiated (partly already implemented) an array of economic reforms, including: support for the business sector through liberalization, growth boost and achieving its long-term sustainability, fiscal consolidation and reform of the banking sector, or trying to attract foreign capital. One of the main features of his reform effort is the symbolic opening up to the world through the deregulation of entry of foreign entities, incentives for foreign capital, and endeavors to encourage trade.

The most tangible is the reform of the tax system, which aims to establish a single Goods and Services Tax (GST). It should make the multi-level and fragmented system of central and federal taxes more transparent, since transfers of goods and services among federal states have been difficult up to now. Effectiveness should be backed up by the actual creation of an internal market, whose existence has so far been weakened by the fragmented tax system. Benefits of the movement of goods and services within the internal market flow not only to foreign firms but also positively influence the competitiveness of domestic enterprises.

An effort to increase the autonomy of individual states and territories in preferential access and investment incentives has the opposite effect. Sometimes it is also called competitive federalism, which is based on the „competition" of individual administrative areas for foreign investors based on different approaches of authorities to the labor market and other areas. It depends on the willingness to reform existing conditions in the given state, or on the appropriately chosen means to attract foreign investment respectively.

The symbol of opening up to the world, called „Make in India", has become the initiative of Prime Minister Modi. It responds to the relatively low development of the secondary sector and aims to attract foreign producers to start their production on Indian territory. Foreign capital and technology inflows should bring job creation and the upgrading of industrial production. The idea of an economy based on exports of manufacturing industry products is a paradigm shift in an economy which is mainly based on services (CNB 2015). However, the taken measures are a logical response to extremely low productivity in both industry and services.

In order to correct the direction of the unfavourable development (firms in the manufacturing industry are very small, unproductive and do not offer enough quality job opportunities, which reduces the share of processed products in export), a whole range of measures have been taken, and dozens of minor and larger interventions are planned. These include, in particular, electronification of contacts with authorities, extension of validity and standardization of official documents, removal of the need to apply for authorization for selected operations, simplification of payment transactions, or elaboration of clear maps with marked claims to foreign entities in the territory (Ministry of Commerce & Industry 2017b). The program's authors have also outlined more than two dozen specific sub-sectors in which a business entity in the Indian market finds the most advantages compared to other countries and is properly supported by the government.[16]

[16] For illustration, there is not just the manufacturing industry, but also the automotive industry and automotive components, aviation and space research, biotechnology, the chemical industry, construction, arms, electronics and systems, food, IT and BPM, leather, mining and

One must not forget the construction of five industrial and economic corridors between major Indian megalopolises, with an emphasis on the planned urbanization and long-term sustainability of not only industrial but also residential areas. The importance of infrastructure projects is enormous, due to the necessity to raise the poor level of infrastructure.

7 CONCLUSION

Despite the apparent similarity of both Asian countries – China and India – in terms of population, geographical location or strong role of the state, a very different structure of their current and financial account has been found out. At the same time, the balance of payments, in its concentrated form, reflects the involvement of these countries in the global economy.

For years, China has evinced very large current account surpluses, which were determined (above all) by an above-average level of savings, exceeding the level of investment. This has been reflected in the export orientation of the Chinese economy, supported by the whole system of state capitalist instruments from thoughtful industrial policy, state investment in infrastructure to engagement in global value chains, and so on. High current account surpluses – while using the fixed exchange rate regime – then found their reflection in the concentration of resources in Chinese sovereign funds. These current account surpluses, especially in relation to the United States, were often subject to criticism as well as the relatively strong dependence of the Chinese economy on consumer demand in the US and the development of the US currency. Currently, an effort to re-orient the population towards an increase in domestic consumption tends to reduce the large current account surpluses, which would also eliminate some of the above-mentioned dependencies.

In the meantime, China is trying to internationalize its currency (renminbi). Trade related payments have been fully liberalized and financial account transactions are being gradually released; China is also broadening the band for exchange rate development, and the Chinese currency reached the top ten most traded world currencies in 2013 and has been involved in the basket of main world currencies along with the US dollar, the British pound, the euro and the Japanese yen since October 2016. The financial account itself, both in China and India, is subject to regulation with a clear tendency toward a gradual opening.

China began its journey to opening up to the world in 1978, and in the past 40 years, it has greatly increased its economic strength and advancement. From the aforementioned list, it is obvious that China is increasingly integrated into the global environment: it selects very precisely what this environment provides and what is not

pharmaceuticals, petrochemical, entertainment, tourism, the hospitality and spa industry, textiles and carpets, thermal energy and renewable resources, railways, ports or shipping.

offered yet, while the economic expansion is supported by direct central management, an absence of democracy and, last but not least, a size of economy that generates a number of benefits.

India (with its comparatively similar size) is very different at this level of comparison: it is the largest democracy in the world, it consists of small administrative units with relatively high autonomy, which can compete with the federal level, and (most importantly) has not opened itself up to globalization too much yet (Bremmer, 2014). Fragmentation and the inability of the country to use its market size seem to be an obstacle to follow the Chinese way of implementing a strong role of the state at this stage of development. The balance of payments' development indicates relatively low involvement of the economy still in both real and financial flows, which is reflected in the low competitiveness of domestic producers. Prime Minister Modi's reforms have a clear objective: to develop the manufacturing industry, to reform the tax system, and to introduce investment incentives for investors.

Definitely, China, as a state-capitalist country, is making much greater use of the benefits of the globalizing economy than India, which is still awaiting an actual opening up.

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