ment of 2003 and the outline of 'goals and guiding principles' for the resolution of bilateral issues signed during PM Vajpayee's visit to Beijing, or the announcement of the India-Pakistan ceasefire at the LoC, the talks towards the '4-Step formula' for Kashmir, or the flagging off of the cross LoC bus, each of these foreign policy initiatives were carried out on Menon's watch. Unfortunately, some of the important work of the time, like Menon's efforts at deftly handling China so that it gave India, not Pakistan its support on the issue of terrorism has been lost in the last few years. Menon himself explains in his book the important changes in 'rising China' that India has failed to factor in. With Pakistan, the current impasse is a far cry of the early days of UPA-1, when action through engagement was preferred over the current radio silence between New Delhi and Islamabad.

Choices is as much a description of the making of Indian foreign policy in the past few decades, as it is a description of the making of Menon as NSA. Most heartwarming are Menon's reminiscences of relations with leaders like Narasimha Rao, IK Gujral, Atal Behari Vajpayee (both as leader of opposition and PM) and Dr. Manmohan Singh. The flexibility, democracy and pragmatism of these negotiations within the Indian foreign policy structure is quite as intriguing as those of India's relations with the world itself.

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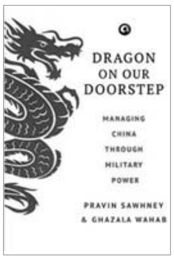
Book News ***Book News***



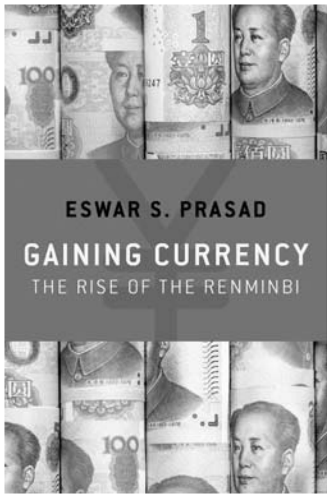
Dragon On Our Doorstep: Managing China Through Military Power by Pravin Sawhney and Ghazala Wahab analyses the geopolitics of the region and the military strategies of the three Asian countries to tell us exactly why India is in a precarious position and how it can transform itself through deft strategy into a leading power. The partnership between China and Pakistan, whether in terms of military interoperability (ability to operate as one in combat), or geostrategic design (which is unfolding through the wide-sweeping One Belt One Road project), has serious implications for India. The best that India can do is try and manage the relationship so that the Dragon's rise is not at the cost of India.

Aleph Books, New Delhi, 2017, pp. 458, ₹799.00

Quo Vadis China

T.C.A. Ranganathan

GAINING CURRENCY: THE RISE OF THE RENMINBI
By Eswar S. Prasad
Oxford University Press, 2017, pp. 248, $29.95



As Fukuyama was visualizing his 'End of History', a giant was stirring–awakened by a unique set of re form policies which liberalized the economics but not the politics of governance. The subsequent rise of China has oft been documented by admirers as also its critics. China is today the world's second largest economy—a GDP of around USD 11 trillion or 15% of world GDP and 12% of world's trade. It helped minimize the effects of the Asian Financial Crisis by refraining from competitive devaluation and, post the Global Financial Crisis of 2008, it represented, for a large swath of emerging market economies in Latin America/Africa/other Asia, the only remaining engine of global growth. While it undoubtedly still lags behind the US economy by a wide margin, its lead over the next largest, Japan, is equally wide. An aspect of China, not often discussed is that barring the forced devaluation experienced in 1993/94 when it suffered a foreign exchange crisis, it has never devalued its currency. The former long-time critic of globalization/ liberalism/capitalism in the early post-revolution decades till the 80s, it not only joined the WTO in 2001, but also went about far more whole-heartedly implementing not only the explicit, but also the required implicit market liberalizations to secure historically unprecedented trade and commerce growth. It consequently received a flood of Foreign Direct Investment inflows and is often called the Factory of the World. Its domestic currency, the Renminbi (RMB), was not used for trade settlement till the turn of the millennium and only accounted for 0.3% of world trade settlement till 2011 but is now around 2%, (over USD 1.3 Trillion or 30% of China trade) making it the fifth most important payment currency. It was recently recognized by the IMF as the world's 5th reserve currency.

The resultant analyst conjectures regarding the prognosis for China have varied, oftentimes wide-eyed with excitement but more often predicting the fall. This book falls in neither camp. It evaluates the China story, post the rise, using the prism of its financial sector; depicting in the process the professionalism of its economic reform and the interconnections linking China's growing economic strength, its expanding international influence and the rise of its currency, the (RMB) to its recent status of an international reserve currency. The nuanced approach nevertheless lands up on the shores of the politics of governance and the limitations it poses for the future trajectory of the China story.

This book is the second offering by the former head of IMF's China division who, in the words of Ben S. Bernanke, is a 'leading expert on International Finance'. Eswar S. Prasad, the Tolani Senior Professor of Trade Policy in the Dyson School at Cornell University, holds the New Century Chair at the Brookings Institute. The book is easy to read. The essence of the argument can well be understood in a quick skim of its short preface and equally short 'conclusion' chapter. However, a detour into the remaining chapters, packed as they are with information and anecdotes, often taking time to explain, in very readable language, several concepts underlying international finance, would be more rewarding, both for the lay reader and the serious academic. The takeaway would be a better understanding not only of China's behaviour but also the dynamics and politics of the current international economic order.

The book begins with a brief history of the evolution of Chinese paper currency, the world's first fiat currency, the internal debates it generated, the twists and turns on its way and even why RMB notes look as they currently do. The views debated some 1000 years ago, regarding the pros and cons of paper currency notes, still echo in various parts of the world. However, doubts notwithstanding, it became a 'fiat currency' by the time of Kublai Khan, the grandson of the legendary Genghis Khan, because none dared, 'at the peril of his life refuse to accept it in payment'.

The second chapter, 'Currency Concepts', discusses how the internal and external concept of 'value' of a currency differ, how currencies fluctuate in value often simultaneously weakening against some but appreciating against other currencies and what it implies to the domestic economy. In the process, the reader is also taken through the intricacies of currency management, the international trading systems, 'off shore' and 'onshore' exchange rates etc., with the help of simple illustrative examples. It delineates three related but distinct aspects of RMB's role in the international monetary system—that of capital account openness, usage as an international means of exchange or 'internationalization' and usage as a 'reserve currency' or holdings by other Central Banks as a protection against a balance of payment crisis. On the way, discussions on 'current account' versus 'capital account' convertibility and free floating exchange rates versus managed rates versus 'pegged' rates and IMF rules also find place.

The chapters on 'Capital Account Opening' and 'The Exchange Rate Regime' document the evolution of China's capital account openness. The author brings out that the policy intent behind China's 'opening process' was not the traditional desire to access foreign financing to spur growth. Instead, the driving force was more oriented towards introducing, indirectly, a catalyst to spur domestic reform. Illustratively, permitting entry to foreign banks creates competition for domestic banks making them conscious of the need to improve efficiency via internal reform. Another equally important driver was the embarrassment created by their own trade success. This started creating large foreign currency surpluses. However, China witnessed a paradoxical situation of having large negative 'net' investment income flows despite having foreign currency asset holdings substantially larger than their foreign currency liabilities (Even in 2014, the Chinese positive Asset/Liability gap was over USD 1.6 Trillion but a 'net' investment income negative by over USD73 Billion). USA shows a reverse behaviour. In a sense, they are losing cash. This resulted in a realization that 'returns' could only improve through a more efficient outward investment mechanism of the generated cash surpluses. This, in turn, implied permitting systematic corporate investment activity overseas, thus a more open capital account.

Two factors determine how open a country's capital account is to inflows and outflows. The first, the de jure, relates to legal requirements on flows, which can range from simple registration or reporting requirements (such as the US requirements that every entrant, citizens or visitors, must declare if they are carrying more than USD 10,000 in cash) to more severe restrictions or 'capital controls' (such as the Indian stance regarding acquisition of domestic firms in some sectors). The second, the de facto, relates to the actual ground reality of enforcement and interpretation.

In the de jure sense, based on an IMF measurement index, China's scorecard reads like India's. But, the reader thereafter is taken on a guided tour of the changes witnessed in the currency, equity and bond markets and in their trading rules through which China has been systematically but selectively and cautiously allowing capital to flow more freely, even if not fully. A methodology best likened to 'learning by doing'. The combined impact of the rapid economic growth and 'opening up' of capital flows resulted in a 6-fold increase, post 2005, in the value of China's foreign currency balance sheet to USD 11 trillion. Also, an inversion occurred in the relative shares of 'official reserves' and 'other overseas investment'.

The next two chapters, 'Promoting International Use of the Currency' and 'Reserve Currency' discuss the mechanics and politics of international payment and settlement systems (the Russian plight after Master Card/Visa blocked even their domestic card settlements post US sanctions in response to Crimea also finds a place) while detailing the process by which RMB became the world's fifth reserve currency with a 10.9 % weight in the basket used to determine the value of SDRs issued by the IMF. It is brought out that even prior to the IMF decision, RMB had started being used as a reserve currency by several of its trading partners. The China National Advanced Payment Systems (CNAPS) and China International Payment Systems (CIPS), Dim Sum and Panda bonds and Offshore RMB clearing systems and direct bilateral clearing arrangements, are all discussed along with the various aspects that determine a reserve currency, the associated dilemmas, internal reform measures, bilateral SWAP arrangements.

In the 1980s China had an 'official 'exchange rate and a separate rate in the official swap centres where demand/supply was permitted to determine the currency value. The official rate became overvalued resulting in a near complete depletion of hard currency reserves by 1994. This forced a devaluation. Concurrently, the two rates were unified and pegged to the US dollar till 2005. In 2005, China dropped the peg and began implementing a managed floating exchange rate mechanism with the currency value determined by market demand and supply and against a 'basket' of currencies, not just the US Dollar. In this, on a daily opening trading rate with a permitted intra-day volatility of 0.3% was announced by the central bank. In 2007 the band was widened to 0.5% and then to 1% in 2012. In 2013, full capital account convertibility was first permitted in the 'Shanghai FTZ'—a small zone within Pudong but outside its financial district. While completely liberalized operations for financial institutions located in the zone is permitted for all FTZ activities and with the rest of the world, they cannot deal with other parts of China, even within that very same city. In 2014, the currency trading band was widened to 2%. In 2015, the FTZ was expanded to include the Pudong Financial District but not to other parts of Shanghai. However, simultaneously three more such FTZs were started in Guangdong, Tianjin and Fujian but again, in small earmarked sections of these cities. In terms of actual values, the RMB had remained constant at 8.27 to a dollar till 2007 where after steady appreciation in rates occurred. In aggregate, by 2014, RMB appreciated by 25% against the US dollar in monetary terms and by 30% in terms of trade weighted exchange rates. In August 2015, the currency was permitted to be fully market determined, thereby complying with a long-standing IMF requirement. Concurrently, China witnessed a stock market crash and a currency depreciation/devaluation igniting fears across the world of a Chinese 'hard landing' being witnessed.

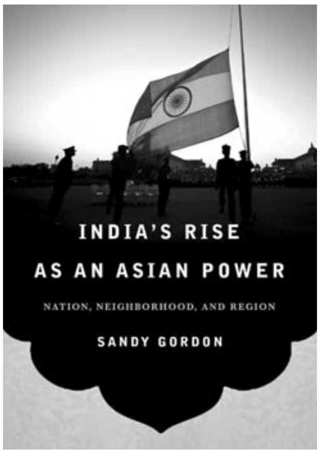
The final three chapters, 'The Mirage of Safety', 'Could China Stumble?' and 'Rising Global Influence' explore the above issues but also what makes currencies acceptable in the absence of a 'fiat'. In the process the reader is taken through an entertaining tour of the world of perceptions, and the importance of perceptions in economics and politics to evaluate the future possibilities for RMB as a settlement and reserve currency. The realm of shadow banking and wealth management products but also the challenges of economic slowdown, the NPA problem as also the growing mountain of public Debt, BRICS Bank and the Asian Infrastructure Investment Bank, the 'Belt and the Road' initiative and the implications of China's political legacies and the personality traits of President Xi Jinping are all visited, with copious information, documentation, data and anecdotes. In the process, the book dispels notions regarding both the 'collapse' and 'world dominance' visions of the Chinese future. The NPA/Banking health/public debt problem, though large and troubling, are all shown to be within manageable range. The management of the various Chinese regulatory institutions are shown, with illustrations, to be professionally competent.

At the same time, exigencies created by politics and political legacies exist. The perceptions of independence, transparency and predictability are important aspects which govern levels of trust and thus, via generated confidence, dependence. In a global setting, this places limitations to the extent to which RMB could currently find acceptability in international holdings and usage. Then again, as the size of an economic system increases so does its complexity. The challenge of 'managing' or 'influencing' the increased heterogeneity of ambitions and desires of individual economic agents also rises in complexity. This in turn brings about an ever-increasing need for institutional independence and the 'rule of law' to ensure perceptibly impartial predictability and safety. The sheer increase in scale due to past successes also exposes the system to experiencing increased turbulence created by externally generated events and 'interpretations' of what 'was managed' becomes ever increasingly more important. What was thus once the mainstay of a 'strong government' now inexplicably, but surely, moves into the province of a 'constitutional democracy' and the earlier 'strengths' thus get converted into brittleness. Herein lies China's challenge.

T.C.A. Ranganathan, an alumni of the Delhi School of Economics and a former CMD of Exim Bank, is currently a freelance writer.

Interlocking Roadblocks Analysed

Gunjan Singh



INDIA'S RISE AS AN ASIAN POWER: NATION, NEIGHBORHOOD AND REGION
By Sandy Gordon
Foundation Books, Georgetown University Press/Washington, DC, 2014, pp. 256, $29.95

India is an important actor in South Asia and it has been extending its role regionally and globally. However, in spite of participating actively India is not regarded as an 'Asian Power'. Sandy Gordon's book juxtaposes the changes which are necessary in the Indian domestic and neighbourhood policies for India to become an 'Asian Power'. It also provides recommendations and actions which the Indian government should undertake to achieve the goal. However, with the change in the Central Government in India in May 2014, some of the arguments and suggestions appear to have already been adopted. The most important suggestion by Gordon is to counter the high levels of corruption, which adversely affect the domestic as well as the regional rise of India. The 'demonetization' drive adopted by the Modi government is an attempt to counter this menace. Other recommendations include the strengthening of the policing system and the judiciary. These two sectors have been in discussion and debate and various governments have been attempting to undertake the necessary actions. The author rightly argues that these weaknesses directly affect the Indian aspirations of becoming a prominent global power.

The major tests of India's diplomatic qualities are in its immediate neighbourhood. As argued by Gordon, most of the Indian neighbours share an adversarial and antagonistic relationship with India. 'India thus tends to be on the receiving end of individual and collective feelings of insecurity on the part of other South Asian countries' (p. 47). Countries like Pakistan, Bangladesh and Nepal have had major issues with India. The situation is further complicated with the presence of China. China has been making consistent inroads in South Asia. The 'all weather friendship' between China and Pakistan is of concern for India. China has been investing in major infrastructure and other projects in South Asia. This has provided the smaller South Asian countries with leverage against India.

India China relations are also complicated because the two share a disputed land border. The border negotiations have not been able to achieve any major solution and thus the India-China relations are mired in distrust. This distrust is extended to the oceans as well. India has a very strong and active navy and also has a very strong influence in the Indian Ocean Region. This natural influence is regarded with suspicion by China who is dependent on the sea lanes of communication for fuels. Beijing fears that in case of a conflict, New Delhi will use its presence in the Indian Ocean to block the flow of vessels. As a result, China has been working towards building major ports around India, like the Hambantota, Chittagong and Gwadar. These developments further feed into the mistrust and negative perceptions.

In this backdrop the suggestion made by Gordon that India should use the Foreign Direct Investment (FDI) coming from China to build its economy does not hold ground. India has real security issues with regard to Chinese presence. Gordon argues, '…India should consider garnering higher levels of FDI from Asia, including from its perceived competitor, China, just as China used capital and technology from the West in its program of modernization' (p. 208). The situation is not the same. The unsolved border issue and the closeness which Beijing shares with Islamabad prevents India from accepting any such investments.

Another important argument which the author makes is the strength of the Indian soft power and how India should be focusing on exploiting this factor. While Indian soft power plays a very crucial role in extending its global reach one cannot deny that it is widely acknowledged that soft power does not work in isolation and needs to be backed with sound hard power capability. The most prominent example in this case is the United States of America. India's Look East Policy is also discussed at great length and the author makes various suggestions for making this policy more relevant. The Modi government has also paid a great deal of attention to this aspect and has renamed the policy as the 'Act East Policy' thus assigning the required attention and importance to India's eastern neighbours.

The author rightly concludes that the South Asian Association for Regional Cooperation (SAARC) has not achieved its potential because of the mistrust amongst the South Asian countries. However, there is need to discuss ways by which this organization can be made functional as there is a need to make the South Asian countries economically more robust and active. Increasing trade relations among the countries can help in ironing a number of differences and thus help in making South Asia a more peaceful region.

Gordon does not give full attention to the India-US relationship. It should not be only viewed from the point of balancing China. India and the US share good diplomatic relations. While discussing the international rise of India the author constantly pitches India against China and Pakistan. There is no discussion of India's positive bilateral relations with countries like the United States, Japan and Australia, Vietnam and South Korea. The author also does not dwell on the question of India joining the United Nations Security Council (UNSC). An UNSC seat is regarded by the global community as an essential measure of global influence and power. BRICS which forms an essential part of the rise of India should have also been discussed.

Gunjan Singh, a researcher at the Indian Pugwash Society, New Delhi is Assistant Editor of the *CBW Magazine*, published by the IDSA and co-editor of *Space Security and Global Cooperation*. She has published in *Harvard Asia Quarterly, International Affairs Review, Asian Affairs, Strategic Analysis, World Affairs: A Journal of International Issues* and *The Book Review.*