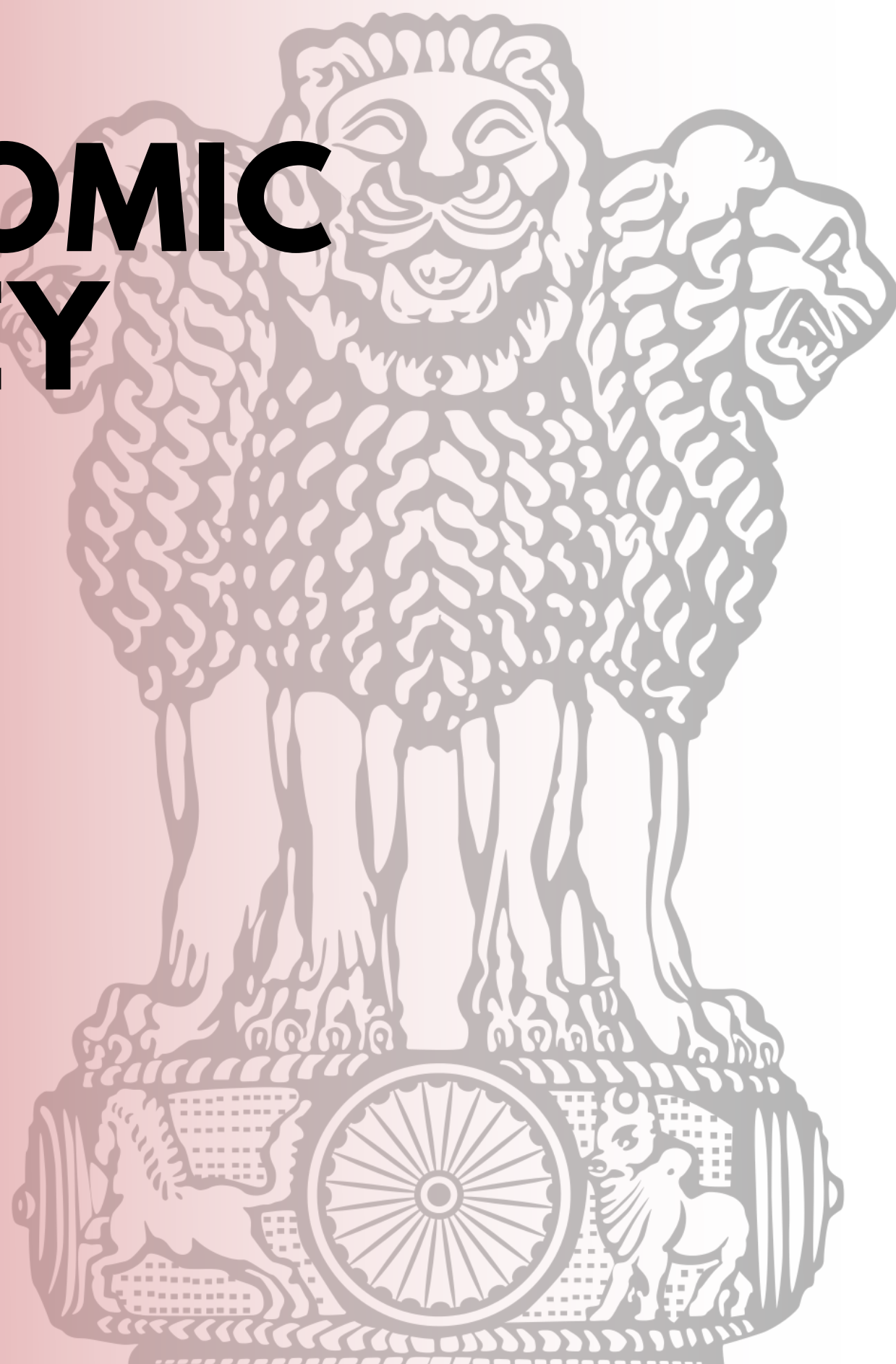


AN ABSTRACT

# ECONOMIC SURVEY 2020



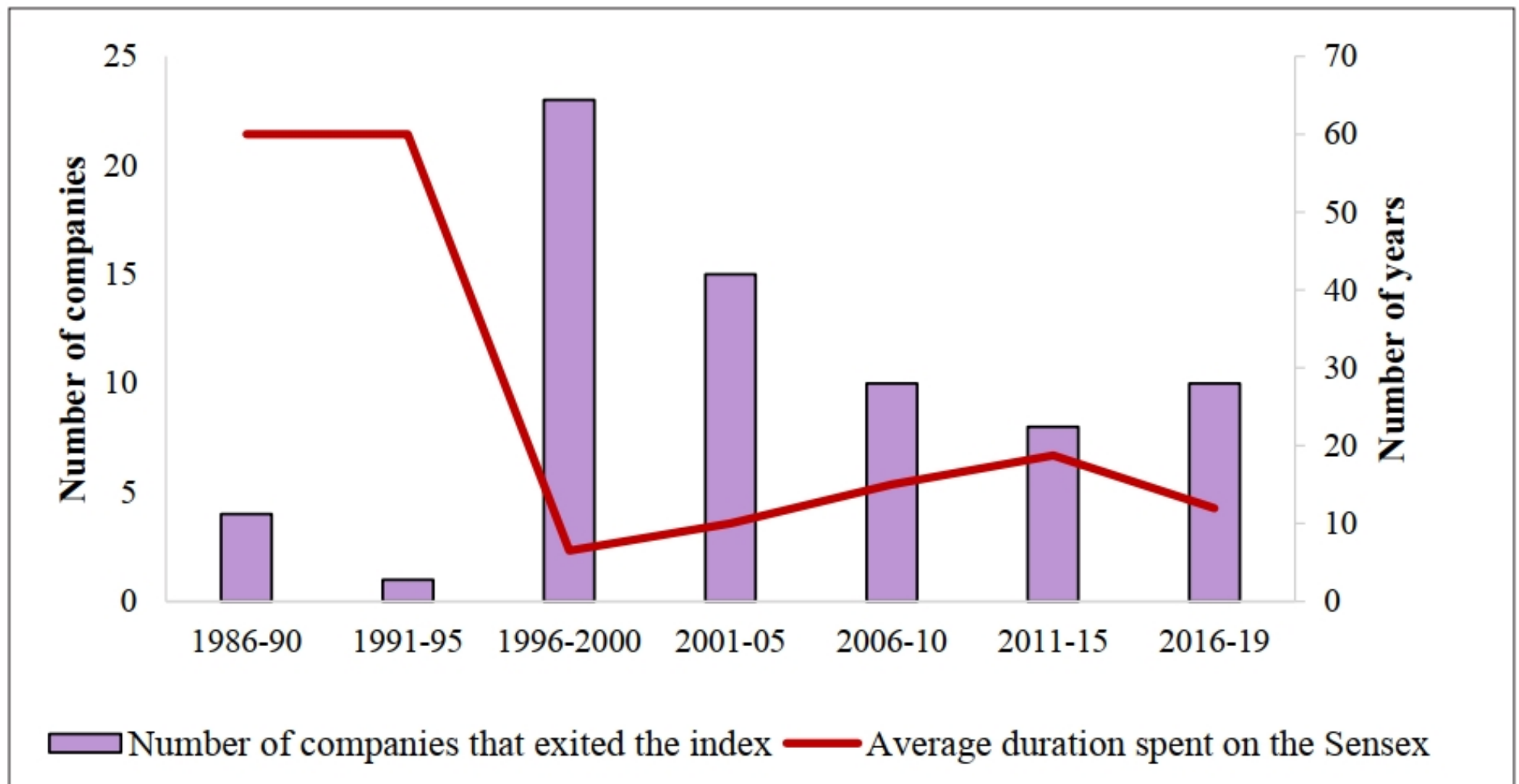
**BRIEF SUMMARY: CHAPTER 3**

# PRO-BUSINESS VERSUS PRO-CRONY

India's aspiration to become a \$5 trillion economy depends critically on promoting “pro-business” policy that unleashes the power of competitive markets to generate wealth, on the one hand, and weaning away from “pro-crony” policy that may favour specific private interests, especially powerful incumbents, on the other hand.

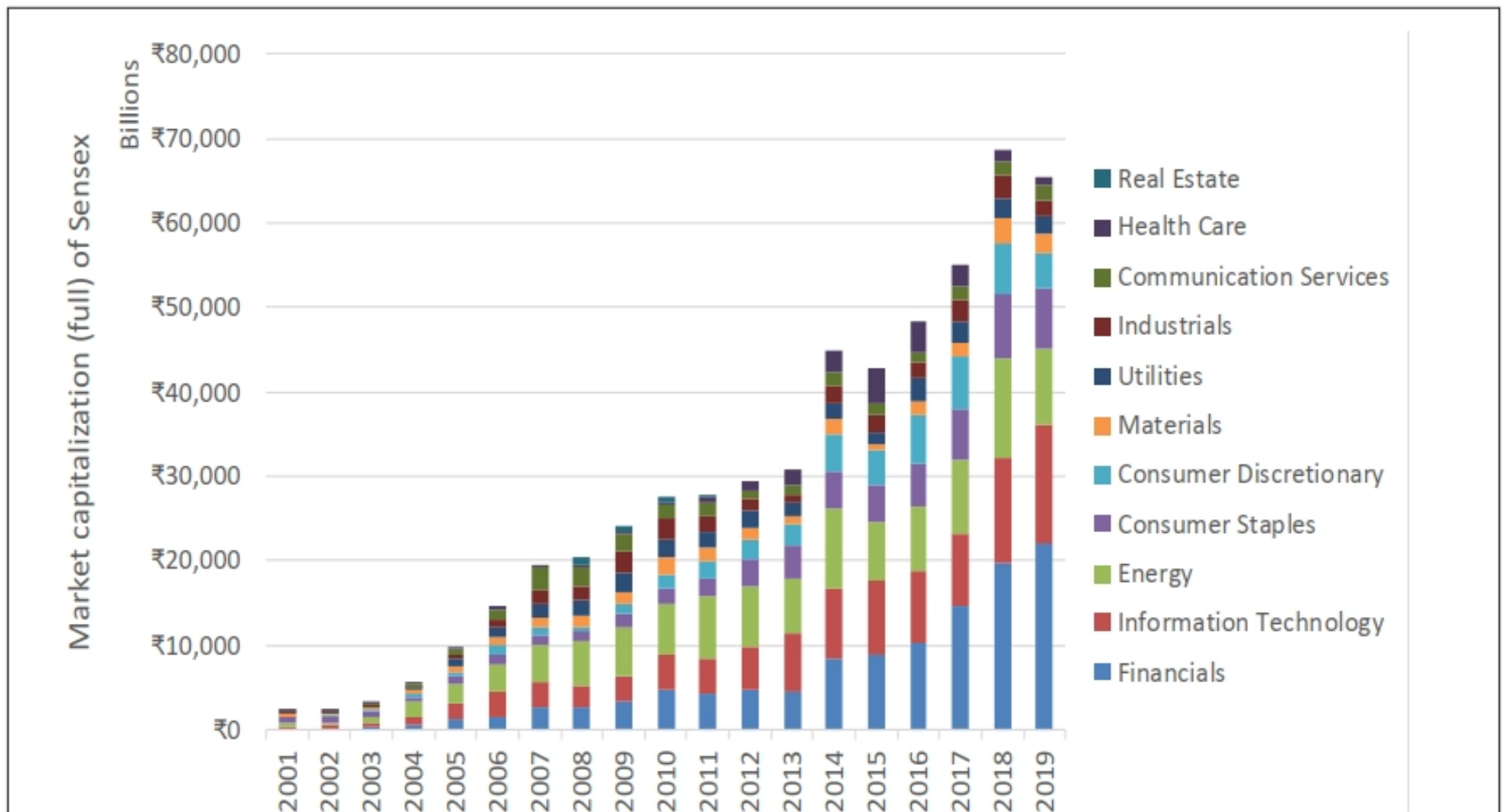
- The liberalization of the Indian economy in 1991 unleashed competitive markets. It enabled the forces of creative destruction, generating benefits that we still witness today. **Joseph Schumpeter who coined the term described “Creative Destruction” as a “process of industrial mutation that incessantly revolutionizes the economic structure from within, incessantly destroying the old one, incessantly creating a new one.”**
- The Survey examined the increase in market dynamism in the pro-business India of the post-liberalization period in context of Sensex. Whereas crossing the first incremental 5000 points took over 13 years and was achieved in 1999, the time taken to achieve each incremental milestone has substantially reduced over the years.
- Beginning in 2014 Sensex saw a revival (after slowdown from 2007-2014) in response to structural reforms and improvement in global liquidity. Strikingly, in this phase, the Sensex jumped from the 30,000 mark to the 40,000 mark in just two years.

Figure 3: Increasing churn in the Sensex



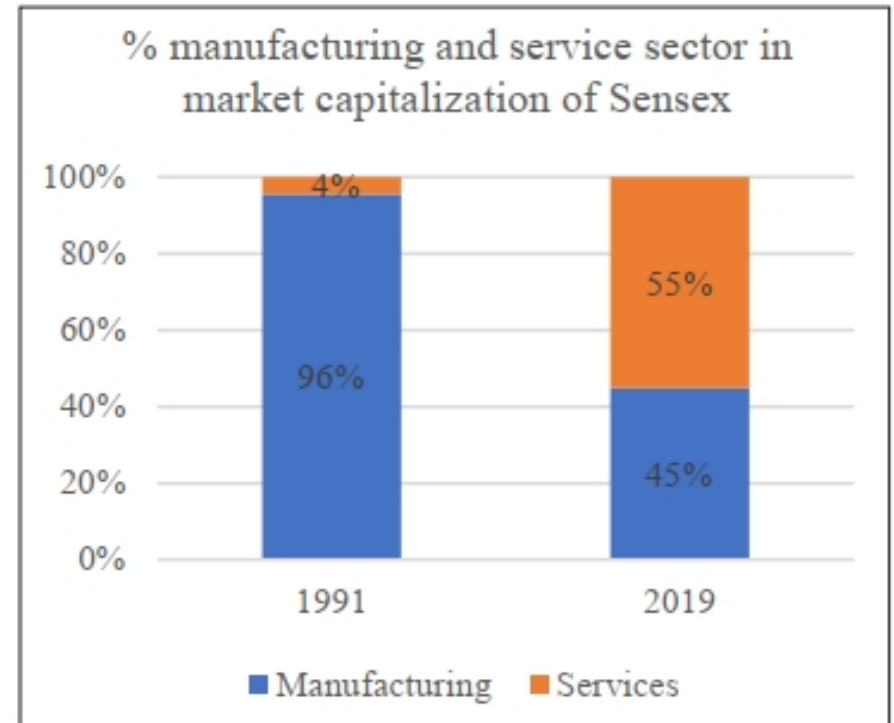
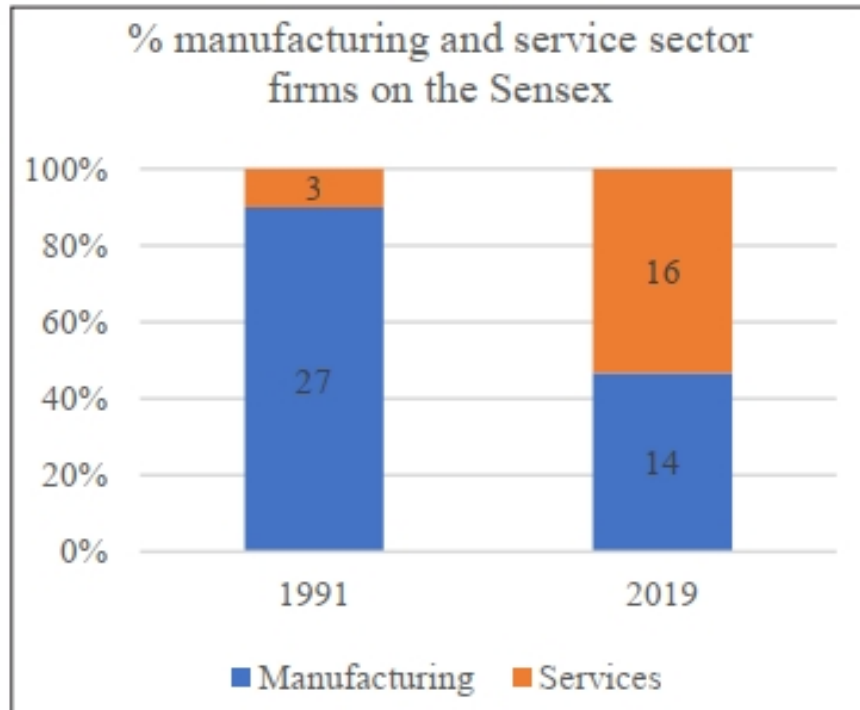
- The relationship between pro-business policy and creative destruction is mirrored in the composition of the Sensex over the years. The years following the 1991 liberalization saw the rapid emergence of new firms, new ideas, new technologies and new operating processes, causing a steep revision. However, in the Indian case, the Sensex does represent a process of creative destruction rather than spurious dynamism. According to Bloomberg, BSE, the sectoral concentration of the Sensex decreased post-liberalisation (i.e. diversity of sectors in the Sensex increased).

**Figure 4: New sectors emerged in the Sensex following liberalization**



- Today's Sensex is far more democratic in terms of the size of companies. In 1991, the largest firm on the index was roughly 100 times the smallest in terms of market capitalization. Ten years later, the ratio declined to roughly 75. In 2018, the ratio was only 12.
- India has followed an idiosyncratic growth pattern, wherein the prime mover of the economy has shifted from agriculture to services. Almost 60 per cent of Indian GDP is attributable to the services sector.

**Figure 6: The rise of services in the Sensex**



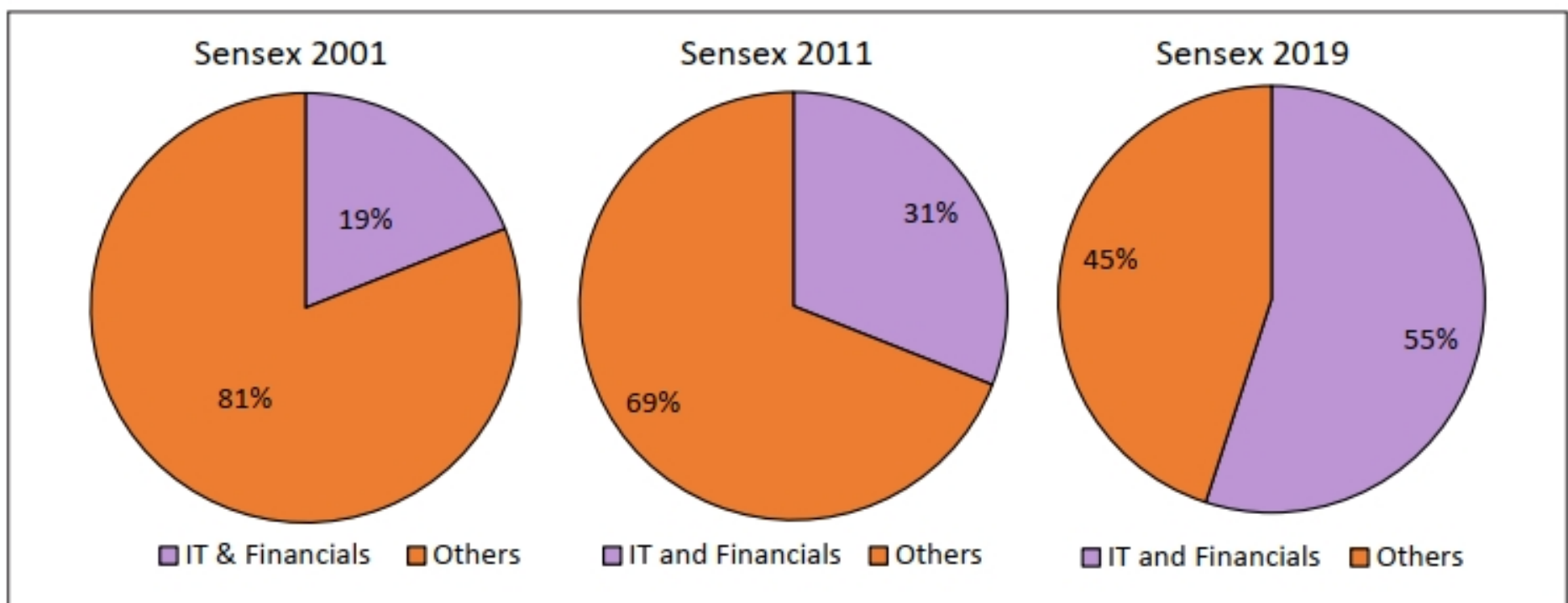
Source: Bloomberg, BSE

- Every five years, roughly one in three firms in the Indian economy can expect to be challenged in a massive way by the forces of creative destruction, consequently monopoly power in the economy is declining and making way for more competitive markets.
- “Saving capitalism from the Capitalists” - Raghuram Rajan and Luigi Zingales stressed the need for it in their eponymous book, referring to the dangers of regulatory capture by private interests. According to the survey, pro-crony policies erode wealth in the economy as cronyism favours inefficiency by inhibiting the process of creative destruction.



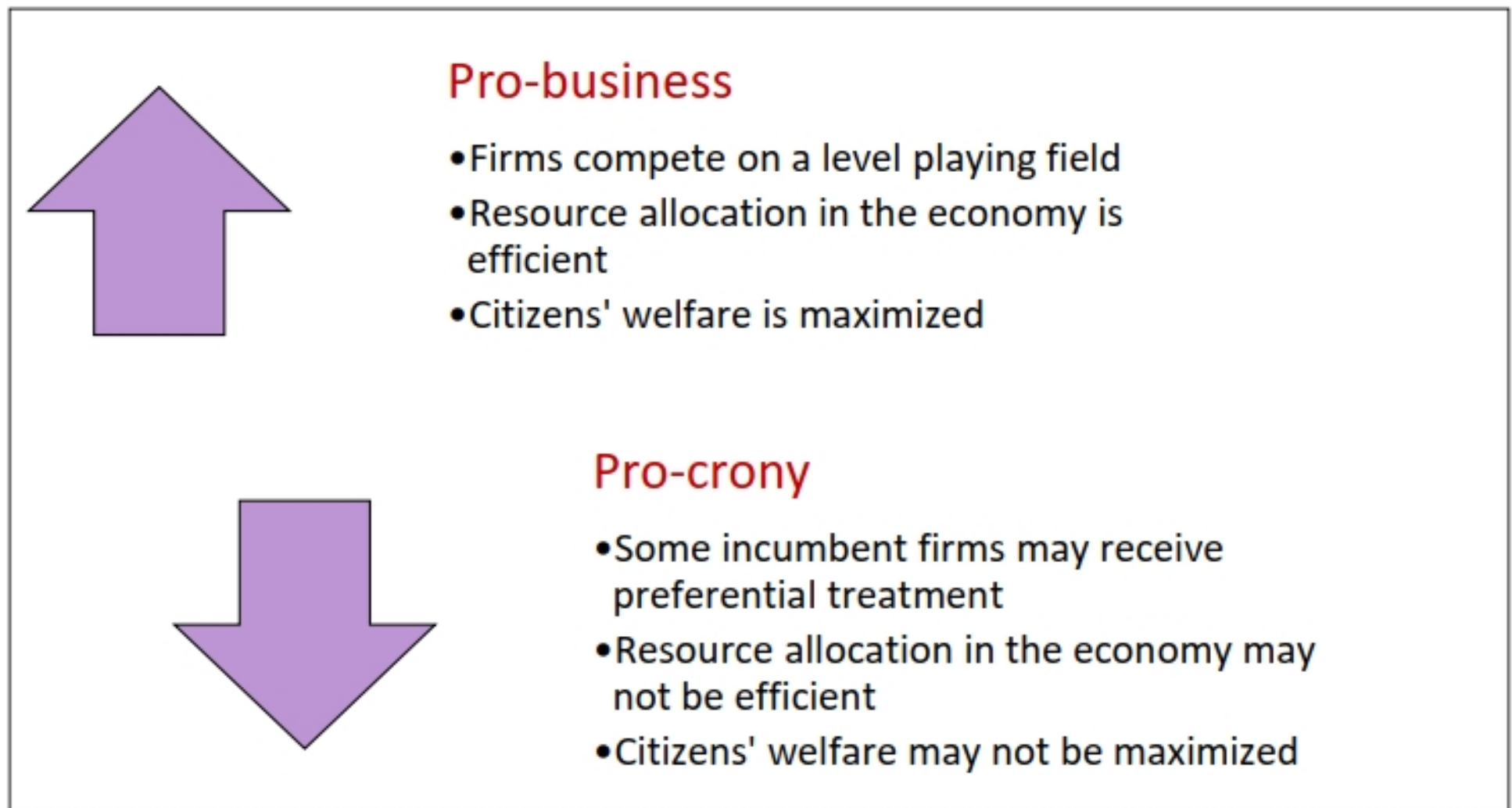
- A recent World Bank study of cronyism in Ukraine finds that the country would grow 1 to 2 percent faster if all political connections were eliminated. Politically connected firms in Ukraine account for over 20 percent of the total turnover of all Ukrainian companies.
- Many businesses in India use their political clout to obtain preferential allocation of projects and resources from the government. A study conducted by Lehne, Shapiro & Eynde reveals that that after close election victories, contractors affiliated to the winning politician are more likely to be awarded road projects and such preferential allocation of roads increases the likelihood of “missing” roads by as much as 86 per cent.

**Figure 8: Increasing Share of IT and Financials Sector in Total Market Capitalization of Sensex**



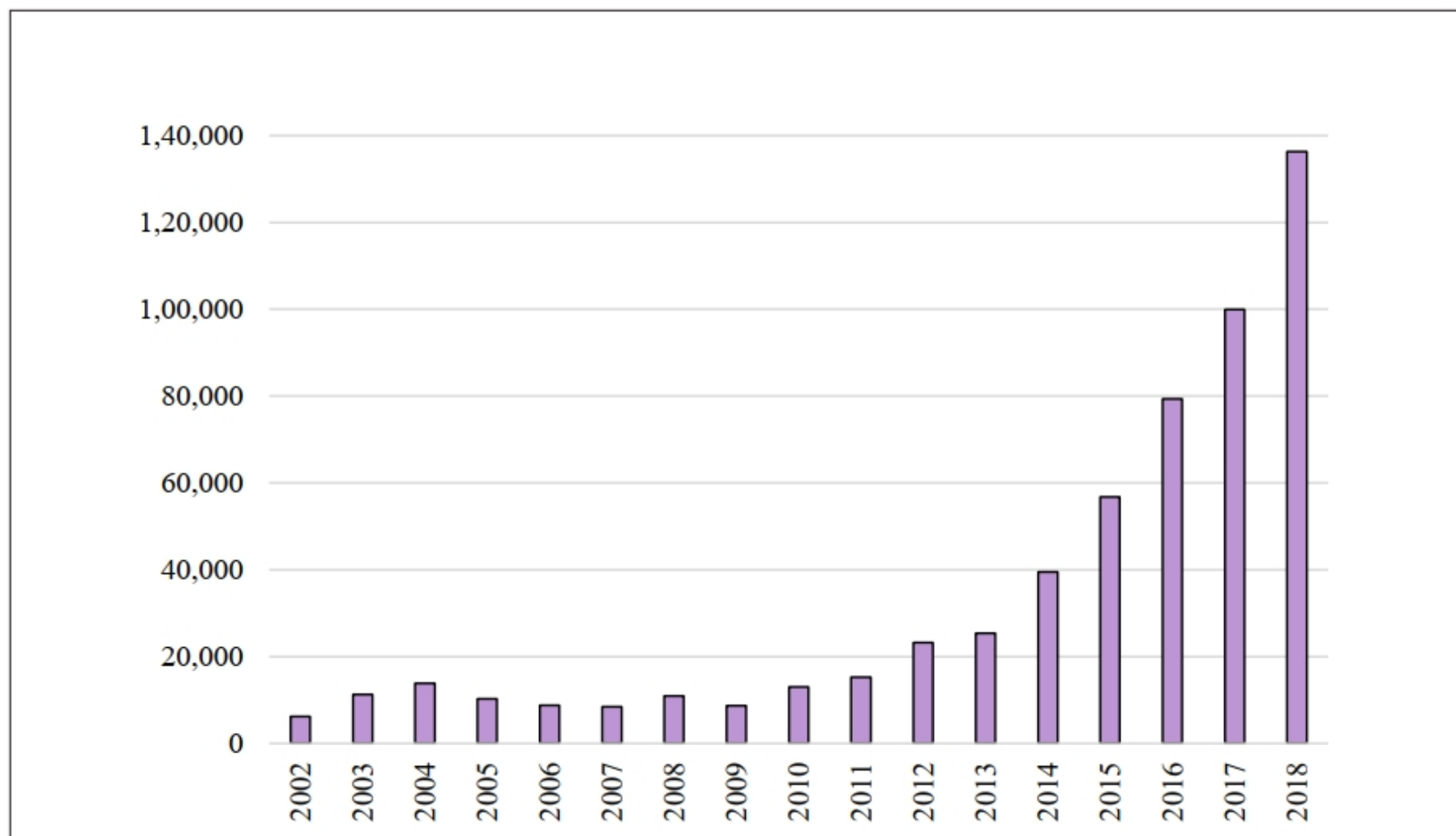
- The survey further enumerated the **disadvantages of the discretionary allotment of natural resources: Rent seeking and Dutch Disease.**
- **Rent seeking** is an economic concept that occurs when an entity seeks to gain added wealth without any reciprocal contribution of productivity. Typically, it revolves around government-funded social services and social service programs.

**Figure 11: Difference between pro-business and pro-crony policy**



- **Dutch disease** is an economic term for the negative consequences that can arise from a spike in the value of a nation's currency. It is primarily associated with the new discovery or exploitation of a valuable natural resource and the unexpected repercussions that such a discovery can have on the overall economy of a nation. Dutch disease is a shorthand way of describing the paradox which occurs when good news, such as the discovery of large oil reserves, harms a country's broader economy. It may begin with a large influx of foreign cash to exploit a newfound resource.

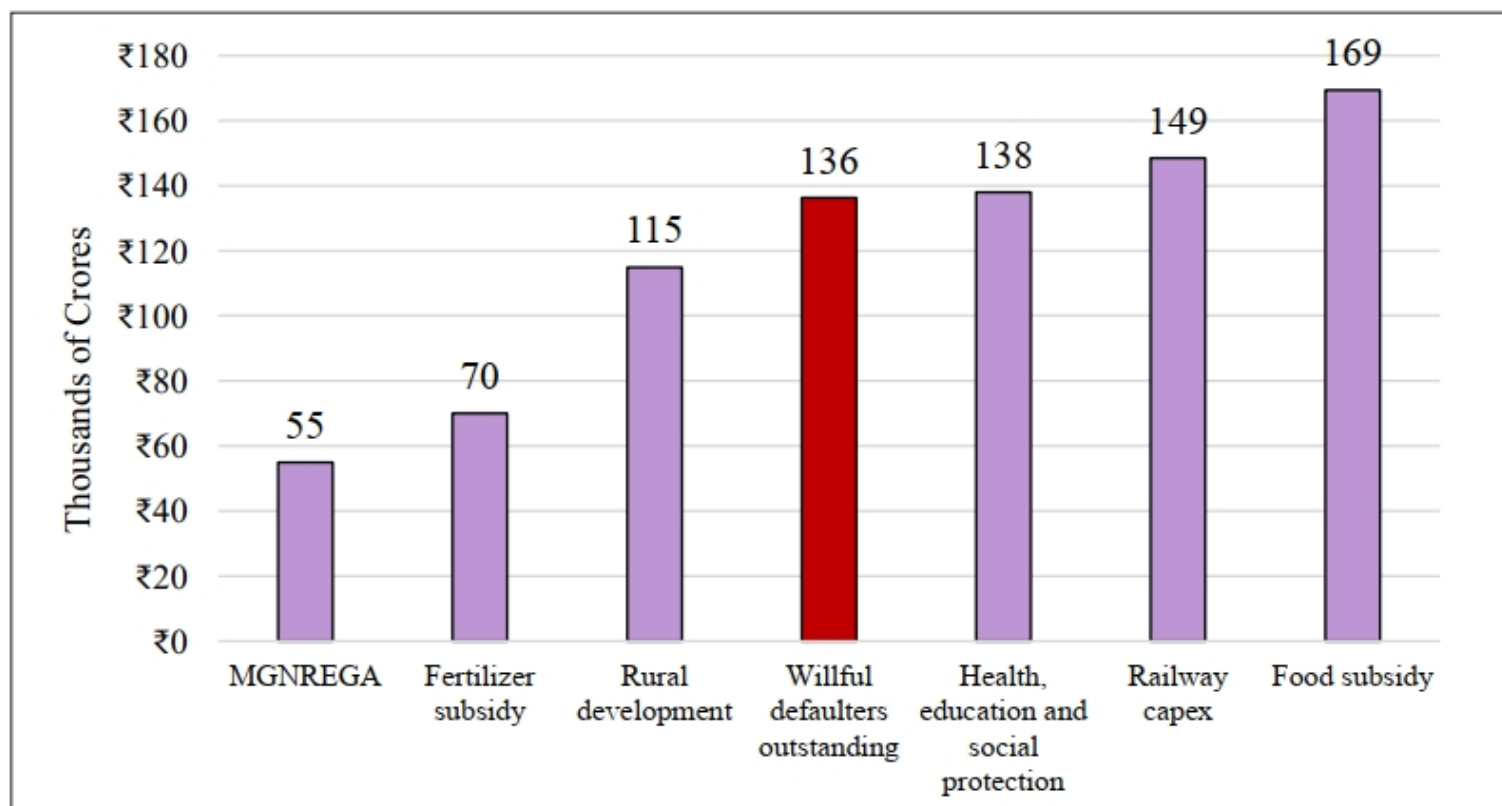
**Figure 16: Aggregate outstanding amount owed by wilful defaulters (₹ crores)**





- **The Case of Wilful Default:** Many firms enjoy profit in good times but often rely on the state or their financiers to bail them out in bad times. A particularly egregious form of such riskless return is the phenomenon of **wilful default – a classic case of a one-way gamble in which “heads, the promoter wins; tails, the lender loses”**. The RBI defines wilful defaulter as a firm that has defaulted in meeting its repayment obligations even though it has the capacity to honor these obligations. Every rupee lent to a wilful defaulter constitutes an erosion of wealth. Had the money siphoned away by wilful defaulters stayed in the economy, the resulting wealth would have been equivalent in value to that needed to double the allocation towards health, education and social protection, double the allocation towards rural development, or triple the allocation towards MGNREGA.

**Figure 18: Wealth destroyed by wilful defaulters in comparison to Union Budget Allocations**



- While pro-business policies increase competition, correct market failures, or enforce business accountability, pro-crony policies hurt markets. Such policies may promote narrow business interests and may hurt social welfare because what crony businesses may want may be at odds with the same. For example, crony businesses may lobby the government to limit competition in their industry, restrict imports of competing goods or reduce regulatory oversight. These initiatives enhance the lobbying group's income but undermine markets and reduce aggregate welfare. Thus, pro-crony policy can inadvertently end up being hurtful to businesses in general.
- 

*This was the summary for Chapter 3, we will share the next summary soon.*