

PROMOTING PRO-BUSINESS POLICY CRITICAL FOR INDIA TO BECOME A \$5 TRILLION ECONOMY SAYS ECONOMIC SURVEY

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Ministry of Commerce & Industry

Promoting Pro-Business Policy Critical for India to become a \$5 trillion Economy says Economic survey

Pro-Crony Policies Erode Wealth & Destroy Value in Economy

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The Economic Survey 2019-20 says 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 Union Minister for Finance & Corporate Affairs, Smt Nirmala Sitharaman tabled the Economic Survey 2019-20 in Parliament today. The Survey said that economic events since 1991 provide powerful evidence supporting this crucial distinction.

The Survey stated that creative destruction has increased significantly after reform. The liberalization of the Indian economy in 1991 unleashed competitive markets and enabled the forces of creative destruction, generating benefits that we still witness today. Creative destruction brings new innovations in the market that serve people better than the old technologies they displace. It brings new firms into the markets, which compete with existing firms and lower prices for consumers. Using the lens of Indian equity markets as captured in the S&P(Standard & Poor's) BSE Sensex, we can clearly see an increase in market dynamism in the pro-business India of the post-liberalization period. After the market reforms of 1991, Sensex has grown at an accelerating pace. 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. Before liberalisation, a Sensex firm expected to stay in it for 60 years, which decreased to only 12 years after liberalisation. Every five years, one-third of Sensex firms are churned out, reflecting the continuous influx of new firms, products and technologies into the economy.

The Survey noted that liberalisation caused a spike in the number of firms churned in the years that immediately followed it, but the churn rate did not decline to pre-liberalization level in later years. New sectors like banks and financials entered the index for the first time, eroding the predominance of the manufacturing sector on the index, placing the services sector on the map for the first time, and reflecting the far-reaching changes that the Indian economy was witnessing in the wake of liberalization.

According to the Survey, the diversity of sectors in the Sensex steadily increased over time following market reforms. The number of Sensex firms in manufacturing has reduced while those in services has increased between 1988 and 2019. Almost 60 per cent of the Indian GDP is attributable to the services.

The Economic Survey 2019-20 observed that pro-crony policies, in contrast to pro-business ones, erode wealth in the economy as cronyism fosters inefficiencies by inhibiting the process of creative destruction. The connected firms proxy firms that may benefit from pro-crony policies. Despite impressive progress in enabling competitive markets, pro-crony policies have destroyed value in the economy. For example, an equity index of connected firms significantly outperformed the market by 7 per cent a year from 2007 to 2010, reflecting abnormal profits extracted at common citizens' expense. In contrast, the index underperforms the market by 7.5 per cent from 2011, reflecting the inefficiency and value destruction inherent in such firms.

- t. Survey pointed out that discretionary allocation of natural resources by a Committee provides avenues for rent-seeking and firm owners divert their focus towards tunnelling away these rents rather than furthering productive economic activities. Pro-crony policies as reflected in discretionary allocation of natural resources till 2011 led to rent-seeking by beneficiaries while competitive allocation of the same resources post 2014 have put an end to such rent extraction. A shift to market-based allocation of resources takes these avenues away, encourages productive economic activity and generates more wealth. Similarly, crony lending that led to wilful default, wherein promoters collectively siphoned off wealth from banks, led to losses that dwarf subsidies directed towards rural development. Every rupee lent to wilful defaulter constitutes an erosion of wealth. As of 2018, wilful defaulters owed their respective lenders nearly Rs.1.4 lakh crores. 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.

The Survey said that wilful default, if unchecked, would increase the cost of borrowing for everyone else, including genuine businesses with profitable investment opportunities before them. Adverse selection may force genuine borrowers to exist the market altogether, leaving only cronies in the market and resulting in a market failure that slows economic growth, employment and wealth creation capacity.

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