PALGRAVE STUDIES IN INDIAN MANAGEMENT

CRONY CAPITALISM IN INDIA

Establishing Robust Counteractive Institutional Frameworks

Edited by

Naresh Khatri
Abhoy K. Ojha

IN ASSOCIATION WITH THE INDIAN ACADEMY OF MANAGEMENT

Crony Capitalism in India

Palgrave Studies in Indian Management

In Association with the Indian Academy of Management

Series Editors: Pawan Budhwar, Aston University, UK, and Arup Varma, Loyola University, USA

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First published 2016 by
PALGRAVE MACMILLAN

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Palgrave Macmillan in the US is a division of Nature America, Inc., One New York Plaza, Suite 4500 New York, NY 10004-1562.

Palgrave Macmillan is the global academic imprint of the above companies and has companies and representatives throughout the world.

ISBN 978-1-137-58286-7 ISBN 978-1-137-58287-4 (eBook)
DOI 10.1057/9781137582874

Distribution in the UK, Europe and the rest of the world is by Palgrave Macmillan®, a division of Macmillan Publishers Limited, registered in England, company number 785998, of Houndmills, Basingstoke, Hampshire RG21 6XS.

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A catalogue record for this book is available from the British Library.

A catalog record for this book is available from the Library of Congress.

To Avantika: Mere Bete, the sweetest girl in the world,
I will always love you – Dad

(Naresh)

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Foreword

Crony capitalism is all about the exercise of discretionary power by a person in authority to favor a select few. It invariably involves back-scratching for either political advantage or profit. In the process it creates distrust and undermines the legitimacy of governance. Cronyism or crony capitalism is certainly not new to India. However, what evokes surprise and concern is the virulence, the stimulus, and the comfort with which it has flourished over the last decade. This concern has fueled the authors of the chapters in this book to have a closer look at the theory and the practice of this phenomenon unfolding in India. The book is an excellent treatise on the subject providing 360-degree exposure to the manifestations of this scourge as it rapidly envelops the nation. It provides a theoretical basis to the phenomenon as it afflicts parts of the globe. An examination of the scandals which engulfed conglomerates in the USA and during the Asian financial crisis serve as an excellent reminder of the negative impacts of free market forces being derailed for personal gain and power.

Crony capitalism has taken deep roots in India. In some ways it can be perceived to be embedded in the basic premises of Indian economic philosophy. However, with the turn of the millennium it has gained a virulence which has transcended all regions, sectors, officials, the legislature, the executive, and the judiciary. Such cronyism ignores, nay negates, every requirement of objectivity let alone a modicum of transparency or accountability. The scourge is so deep-rooted that several transformational developments taking place in the country present opportunities for this section of players to try to divert attention making in government and public institutions for their personal agenda. These people have become the most insidious threats to a healthy economy or in fact a vibrant democracy which is premised on equality of opportunity to all and a level playing field. The play out of such a phenomenon needs to be urgently countered. It will be futile to expect the government or the legislature to take any initiative against such cronyism *as the entire phenomenon is of their own making*. The malaise can be tackled only by a public spirited campaign, which exposes all wrongdoing and seeks to create an environment which compels government, to not only be transparent in its decision making process, but holds it accountable for its decisions. Crony capitalism is not new to this age either.

The occurrence of coincidence for a select few has always evinced interest of them being the beneficiaries of political or government patronage. Cronyism has created oligarchs, who in turn have made entrepreneurial passion lethargic and have debilitated competition. It has discouraged the pursuit of excellence, derailed professionalism and introduced a mood of despondency.

The analysis of the cultural context and its correlation to the phenomenon of crony capitalism as observed in India is very illuminating. It needs to be emphasized that the last decade has seen the emergence of a behavior pattern, which has created disharmony and dissonance between the government and the people who voted for them. With the creeping in of discretion in enforcing rules and regulations, attempts at cornering national and natural resources, disregard for societal values or concerns, and the all-pervading 'influence peddling', those in powerful positions have created a vicious cycle, whereby only the 'influential' will continue to reap the benefits of government spending or exploitation of the nation's finite natural resources. We have seen remarkably innovative constructs for cornering of such resources. What causes greater consternation are the highly imaginative justifications trotted out to justify such cornering of state patronage. An even more dangerous trend is the realization among the awakened citizenry that people in such authoritative positions have begun to believe that since they have been chosen to 'govern' for a certain tenure, they are empowered to exercise such arbitrary patronage. Such patronage need not only be in contracts or economic issues, but is also observed in bestowing of state recognition such as Padma awards and even the Bharat Ratna. The grant of one such Bharat Ratna award in the sports category in the recent past, however deserving it may have been, did give ground to the belief that the decision was taken by a miniscule coterie and definitely with the motive of narrow political benefits.

Having been a witness to events unfolding in the not too distant past, one has to come to the inescapable belief, that cronyism or crony capitalism or the very display of favoritism is encouraged in covert and innovative ways such that the pattern becomes self-supporting to suit those seeking to disrupt and derail inclusiveness, equity or any form of fair decision making. The malaise has spread its tentacles in government functioning, sports bodies, educational institutions, regulatory bodies, judicial appointments, media or any other form of 'influence capture'. Family oligarchies or family capture of political institutions have ensured that these remain aligned to the political construct of the times. It is mind-boggling that the capture by an 85-year-old politician of a sports body, as its presiding deity, for close to 40 years can also be justified! It is ascribed to the 'marvels' of democracy and the election process wherein the elected person is 'humbled by the margin of his victory in the body reposing faith in his stewardship'. If it were a leadership, a la Lew Kuan Yew, the results would have been available for all to see and hail, but the capture by a select few renders the entire process a farce, without an iota of remorse or guilt among the perpetrators of such designs. How does the citizen counter this? How is it that government officials and corporate leaders retire at the age of 60 or 65 and an 83-year-old can hold probably the most demanding political appointment in the country? The time has come when a discerning and demanding citizenry asks these questions and makes concerted efforts to negate such insidious designs.

The Indian Civil Services have come in for very sharp criticism in the last few years. No doubt the expectations of its continuing to live up to its famed legacy of being 'a steel frame', has been belied. The reasons for this can be many. The realization in the political executive of the powers of the administration, and its potential to defray patronage, has resulted in the politician arrogating that authority unto himself in the garb of being answerable to the Legislature and the public at large. The civil service has also witnessed creeping insurgency of factors such as caste, regional, language and political affiliations. A very major contributing factor to this malaise has been the inexplicable increase in the upper age for recruitment to these services. Whereas a trainee in the age group of 22 or 23 years can be molded, trained and inculcated with the qualities of an objective and efficient administrator, the capacity for similar training of a person at the age of 31 or 32 years of age at the time of induction in the service, would be severely diminished. Juxtapose this factor with the realization among the new entrants of the latter age group, that they would – like all others – retire at the age of 60 and hence, would have a career span of only 28–29 years as against a normal span of say about 35 years, in a governmental system dominated by the principle of seniority, would not permit his reaching the highest echelons, is bound to derail his career aspirations. This would naturally divert his interest to other areas where he sees greater 'benefit' for himself. Hence the lack of demonstrated objective behavior.

The study by Vishal Gupta of IIM, Ahmedabad, in Chapter 9, of how the IAS has been resistant to reform and its relationship to crony capitalism needs a wider discourse. These features need to be squarely placed before IAS officers for deep introspection. I strongly believe that this analysis is a befitting case study for new entrants to the civil service at the Lal Bahadur Shastri National Academy of Administration to know what safeguards they need to build in. It would also serve as an excellent pointer to the phases III, IV, and V in service trainee officers to seriously reflect their behavior and actions. The recommendations are well thought out and deserve a nationwide discussion as any further deterioration in the quality of administration will have disastrous consequences. It needs to be recognized that economic growth cannot be made sustainable in the long run unless it is nurtured and incubated in an environment of good and ethical governance. I would sincerely recommend a nationwide debate on these issues. Well-informed and well-intentioned civil society members must contribute in the debate, to put pressure on the powers that be, to undertake the reforms that many committees have recommended for the civil services.

Every epidemic, malaise or affliction has an appropriate time within which it should be addressed. The cure has to be from sources within as well as external. There should be an element of self-belief and purity of purpose. Personal interests and aggrandizement cannot always eclipse every other public and community interest. Democracies and governments are meant to empower people and not emasculate them. The nation needs to learn from history – from the travails and demise of the East India Company, probably the first ever multinational, the Enron and Dabhol imbroglio, the Satyam saga and the lakhs of crores of rupees of bank money awaiting resolution in the corporate debt restructuring mechanism. These are outstanding examples of the deleterious effects crony capitalism can have on institutions meant to support growth. The conventional wisdom of a government taking the lead to root out the evils that have crept into society no longer holds any relevance. The scourge will require paradigm change. There have been signs of such citizen-centric initiatives. However, they need to be sustained and get broader support. Only an awakened citizenry and a public-spirited campaign can compel the government and political executive to reform themselves. Robust accountability institutions should be permitted the freedom of action. Their observations need to be acted upon. Competition promotes efficiency, decreases cost and leads to better delivery of services to the society. I am very sanguine that the predominantly young human capital that the nation possesses has awakened to the need of the hour and is looking for leaders, directions and support from the more aware among the public. I have great faith in the fact that we are on the cusp of a revival – a revival which will be fueled by public participation in governance.

I sincerely commend this book for a very wide readership. The issues contained in it touch every strata and institution of the country. We need to apply ourselves with dedication and sincerity of purpose to ensure that the youth of this country have trust in their government and that there is no dissonance between the people and the government they give unto themselves.

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Preface

The ideas in this book have evolved over many years. The thought of cronyism occurred to the first author after observing a pattern of promotions from assistant to associate professor in a large university setting. It seemed to him that more qualified individuals were not receiving promotion but being passed over in favor of those who were less qualified. Especially striking was the case of two individuals, one highly qualified and the other not. The former was outstanding in both research and teaching and deserving of promotion based on either research or teaching alone, while the latter lacked in both areas.

This and other similar examples raised a question in his mind. He had experienced first-hand organizational settings in which the level of incompetence and unethical behavior was more common as compared to others (perhaps most of us have encountered such situations at one time or another), with obvious implications for organizational performance. The concept of cronyism seemed to encompass these issues, and thus started our journey to study the phenomenon in more depth, culminating in this book. We were warned (the first author in particular) that cronyism is too sensitive an issue and that it may be controversial and risky to examine it, especially in the highly authoritarian setting that the first author was part of at the time. Nonetheless, the research on cronyism was pursued with our undergraduate students, resulting in the first presentation at the Academy of Management Conference in Toronto in 2000. Since then the first author has published several research articles with colleagues on the subject that have been received well by the research community.

The chapters in this book emerged from a symposium, 'The Indian Brand of Crony Capitalism', held at the Academy of Management Conference in Philadelphia in 2014.

Crony capitalism is emerging as one of the most important topics in various but related fields such as business management, economics, ethics, political science, and public administration. It is especially so in the Indian business and economics context. Despite its importance, it has not received sufficient attention from scholars studying Indian management. The scope of the project is ambitious in that it attempts to address the key underpinnings of this complex and multifarious issue in a single book.

We bring together experts from various backgrounds to provide a comprehensive treatment of the topic.

The book has been planned to meet the needs of students, teachers, and scholars in a variety of fields such as business management, economics, ethics, political science, and public administration. We are surprised that a comprehensive treatment of such an important topic has not hitherto been made available and believe that a book like this fills an important gap. Further, given the emergent nature of the Indian economy, it is hoped that it will provide important information for decision-makers in both government and business to help establish a robust institutional framework that is so desperately needed. In addition, the book will be of interest to an international audience for two reasons. First, both businesspersons and academics are watching India with great interest because of the size and dynamism of its economy. Second, there may be useful lessons for both developing and developed nations from our understanding of the Indian brand of crony capitalism.

The topic is of global interest and thus the book is likely to be of interest to students, scholars, policy makers, and practitioners in Europe, the USA, and other Asian countries, such as China and Japan that might be looking forward to deepening economic ties with India. Considering the increasing interest in the BRIC economies, readers in Brazil, Russia, and South Africa may find this book particularly relevant.

Other than newspapers, social media, and TV, there has been a dearth of writing and discussions on the topic of crony capitalism. We feel therefore that a book of this kind is sorely needed. Our goal throughout has been to provide a good quality text that addresses this important topic and we hope that we have succeeded.

Naresh Khatri and Abhoy K. Ojha

Series Preface

The Indian Academy of Management (INDAM)

The Indian Academy of Management (INDAM) was formed in 2007 to provide a platform for scholars doing research related to India where they could exchange ideas and share resources. The first conference was held in 2009, following which the Academy was officially granted affiliate status by the Academy of Management.

Over the last few years, INDAM has been a regular presence at AoM meetings, organizing Caucuses, Professional Development Workshops, and increasing its presence through members' presentations at competitive paper sessions. In addition, INDAM has organized 4 highly successful conferences in India (2009; 2011; 2013; 2015). INDAM members have also been active in promoting research in India, through mentoring and conducting paper-development sessions at various leading management institutes.

At the 4th conference, INDAM launched the INDAM-PALGRAVE series which will present books on topical issues relating to developments in India. This book, co-edited by Naresh Khatri and Abhoy Ojha, is the first in this series.

On behalf of the INDAM board, we want to thank everyone who has helped make INDAM a successful platform for academics and practitioners interested in India-related management research.

We look forward to serving and educating our audience(s) for many years to come!

Pawan Budhwar
Founder and Past President

Arup Varma
Founder and Past President

Acknowledgments

We are grateful to Pawan Budhwar and Arup Varma for considering the book as the first title in the series 'Palgrave Studies in Indian Management' by the Indian Academy of Management. We hope the book will provide a flying start to the series. We would like to thank our colleagues who contributed the chapters. Without their timely and wholehearted support, this book would not have been feasible. They did not mind our nagging and stepped up when it really counted.

Chapter 2 appeared previously as Khatri, N. & Tsang, E. W. K., Antecedents and consequences of cronyism in organizations. *Journal of Business Ethics* (2003) 43: 289–303, and is reproduced here with permission from Springer.

Chapter 3 has been adapted from Khatri, N., Tsang, E. W. K., & Begley, T., Cronyism: A cross-cultural analysis. *Journal of International Business Studies* (2006) 37(1): 61–75, and is reproduced here with permission from Palgrave.

Naresh Khatri: This book is dedicated to the loving memory of my sweet and beautiful daughter, Avantika. She made me, my wife, Kusum, and my son, Aaditya, feel like the happiest and luckiest people on earth for 21 years. Avantika was a blooming flower and a breath of fresh air in a world that can become inhospitable and suffocating at times. She was so honest, genuine, idealistic, bright, always thinking of how to make the world a better place. I found her a far more mature and evolved person than her age would suggest. Perhaps, she was too good for the world that we live in. She had such a great promise. Indeed, she would have done phenomenal things. She taught me many things that really mattered in life. For example, she would suggest: 'Dad, anger and pride can be quite harmful.' The last movie that we shared as father and daughter was *The LEGO Movie* with the song 'Everything is awesome'. This song has since become part of my everyday vocabulary, especially in my teaching, when I need to inspire my students. Given her interests in economics and political science, we had great discussions and arguments about the core ideas in this book. I would have hoped for her compliments on this book, which would have mattered to me more than anything in this whole world.

About the Editors

Naresh Khatri is an associate professor at the Department of Health Management and Informatics, University of Missouri, Columbia. He holds a PhD in Organizational Behavior and Human Resources from State University of New York, Buffalo, and an MBA from the Indian Institute of Management, Ahmedabad. Before joining the University of Missouri, he was faculty in the Department of Strategic Management and Organization at the Nanyang Business School, Nanyang Technological University, Singapore, for many years. He has authored two scholarly books and published numerous articles in *Asia Pacific Journal of Management*, *California Management Review*, *Health Care Management Review*, *Human Relations*, *Human Resource Management Journal*, *International Journal of Human Resource Management*, *Journal of Business Ethics*, *Journal of International Business Studies*, and *Journal of World Business*. His co-authored research paper, 'Great (Transformational) Leadership = Charisma + Vision', received the Emerald Literati Network's Award for Excellence. Three of his papers have received nominations for the Best Paper award at the Academy of Management Conference. He has received many research grants. His recent research grant from the Agency of Health Care Research and Quality, National Institute of Health, on HR and IT capabilities in US hospitals was rated exceptional.

Khatri is the Senior Associate Editor of *South Asian Journal of Global Business Research* and the Associate Editor of *IIMB Management Review*. He is on the Editorial Board of *Health Care Management Review* (2008–2012), *Journal of Hospital Administration*, and *Journal of Management and Public Policy*. He received the 'Teacher of the Year' award in the Department of Health Management and Informatics in 2006. As a faculty at Nanyang Business School, Singapore, he conducted executive workshops on leadership and strategic human resource management for Matsushita, Samsung, and the Ministries of Defense and Environment, Singapore.

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He worked as an engineer in the Bombay Division of the Oil and Natural Gas Commission, before pursuing doctoral studies in management. He has been an active researcher having presented his work in conferences of repute and published in domestic and international journals, and contributed several book chapters. He has been a member of many professional bodies, including the Academy of Management, Administrative Sciences Association of Canada and Indian Academy of Management, and on editorial boards of a few journals, including *IIMB Management Review* and *South Asian Journal of Global Business Research*. He has also undertaken several consulting and training assignments in the private sector as well as in the government and public sector.

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Part I

Cronyism, Corruption, and Crony Capitalism

1
Definitions of Cronyism, Corruption, and Crony Capitalism

Naresh Khatri

Introduction

Crony capitalism is an extension of the generic concept of cronyism as it applies to businesses and firms in a nation or society. A politicized or rigged economic system is dubbed crony capitalist to distinguish it from a system of free markets and limited government. It is the deliberate, systematic use of public policy to rig markets in ways that benefit politically connected actors. Crony capitalism breeds political entrepreneurs and stifles market entrepreneurs. By killing transparency and competition, it is harmful to free enterprise, opportunity, and growth. By substituting special interests for public interest, it is harmful to democratic expression and leads to income inequality and the middle-income trap, the often observed slowdown in growth that occurs once developing countries reach middle-income levels.

The study of corruption and cronyism cuts across diverse perspectives and embraces the academic disciplines of economics, political science, sociology, psychology, ethics, administration, and religion. The ever-expanding and cross-disciplinary literature on corruption and cronyism reveals the complexity and multifaceted nature of their causes (Laver, 2014).

One of the most common definitions of corruption is the use of public office for private gain. In virtually every society, historians and anthropologists have found that public affairs are distinguished by their exceptional privileges and trappings. Activities most prone to corruption include bidding on public contracts, the use of public funds, defense contracting, the handling of property, tax assessment and collection, zoning and land use, the legislative and elective processes, law enforcement, and the administration of public services (Caiden, 2001; Elliott, 2012; White, 2001).

However, the conventional definition of corruption as the use of public office for private gain is unnecessarily restrictive. Corrupt exchanges can take place not only between a public agent and a private agent, but also between one private agent and another or between one public agent and another. Thus, a broader definition of corruption that includes all types of agents and exchanges between them is more useful.

The most basic definition of 'cronyism' is the preferential treatment shown to old friends and associates without regard to their qualifications (Khatri & Tsang, 2003). Cronyism can occur in two basic forms: instrumental and relational (Khatri, Tsang, & Begley, 2006). Instrumental cronyism is motivated primarily by task, utilitarian, and self-interest considerations. Although the value and time period for exchange of favors are implicit, the exchange of favors usually takes place over a relatively short time and the value of favors exchanged tends to be more or less similar. Relational cronyism, on the other hand, has relationship, affection, and loyalty at its core. It is long term in its orientation, that is, the exchange of favors in relational cronyism takes place over a long period and the value of favors exchanged can differ greatly depending on the relative statuses of the giver and taker.

Although cronyism usually gets lumped with corruption, it is distinct from corruption. Cronyism is based on a tie or a connection or a relationship between actors and involves implicit, unspecified, and reciprocal transactions with no stipulation of a time period during which favors must be returned (Khatri et al., 2006). Unlike corrupt exchanges, cronyistic exchanges, more often than not, are based on trust, loyalty, and longstanding friendship. A review of the literature on corruption suggests that most so-called corrupt exchanges may actually be acts of cronyism, because corrupt exchanges often involve collaborators (Krug & Hendrischke, 2003; Roberts, 2010). Corruption is by far the more commonly used term in India, although cronyism appears to be far more pervasive in India and underlies even acts of corruption.

The phenomenon of cronyism is misunderstood when it is classified under corruption or malpractice (Mitchell, 2012). This combined with the fact that corruption is usually a symptom of institutional deterioration rather than the cause of it (Mudambi, Navarra, & Delios, 2013) means that research could benefit by focusing more on cronyism rather than corruption. Cronyism seems a more dynamic phenomenon and has greater explanatory power: it addresses the 'how' and 'why' of corrupt acts in India. In this book, corruption and cronyism are used interchangeably with greater emphasis on cronyism.

In crony capitalism, power and favors are wielded, exchanged, and acquired via an intricate system of personal contacts, favoritism, and championing of interests. Holcombe (2012) characterizes it as a system in which the profitability of a business depends on political connections. It results when those in political power alter the structure of incentives that firms face by providing profit opportunities for individuals who invest in political lobbying, campaigning, and relationships rather than in true profit opportunities (Olson, 1982). Consequently, the greater the political influence in economic decision-making, the greater the likelihood of crony capitalism. Limited government may partly be the solution to the problem of crony capitalism rather than greater governmental intervention in the economy (Haber, 2002); this argument has been elaborated in Chapter 4.

The structure of governmental institutions affects the level of malfeasance within a country; the root causes of malfeasance may lie in institutional weaknesses (Shleifer & Vishny, 1993). Cronies often stonewall the establishment of fair and transparent laws because such laws hamper their freedom to wheel and deal (Holcombe, 2012). An improvement in institutional quality reduces the shadow economy directly and reduces corruption both directly and indirectly (through its effect on the shadow market) (Snow, 2011). Acemoglu and Robinson (2012) reason that the ultimate cause for economic success or failure is rooted within each country's institutions and that understanding how these institutions evolve is crucial for development.

Garen (2012) argues that when government becomes a vehicle for soliciting and rewarding cronies or interest groups, the society in which this happens heads toward crony capitalism and its consequences: mistrust in government and other institutions, economic stagnation, and social discord. Crony capitalism engenders a higher return on developing lobbying and political skills – that is, becoming a crony – rather than on developing economically productive skills. Business activities end up in the hands of those who are good at making political connections (political entrepreneurs) but not in the hands of those who are innovative and risk-takers (market entrepreneurs). Consequently, unimaginative, unproductive, inefficient, and wasteful economic initiatives, programs, and businesses are likely to be the hallmarks of an economic system riddled with crony capitalism.

Cronyism is not simply a zero-sum game that takes from some and gives to others; it is a negative-sum game (Haber, 2002; Henderson, 2012). The losses to the losers substantially outweigh the gains to the winners.

In other words, cronyism destroys wealth. Under cronyism, the government rigs the market for the benefit of the cronies of government officials and, by creating privilege, transfers wealth from the many to the favored few. Crony arrangements lack transparency to the extent that a system rife with cronyism has a certain degree of legitimacy among the general public. This legitimacy seems to exist only thanks to certain amount of stealthy behavior and deception on the part of privileged economic groups and politicians complicit in providing those privileges (Aligica & Tarko, 2014). Under crony capitalism, politicians, government officials, and businesspersons must be able to make deals without public review and approval. Crony systems are not consistent with high levels of political democracy (Haber, 2002). Indeed, the more authoritarian the government, the more efficiently the system can work.

Crony capitalist coalitions invariably encompass big businesses and big banks. In order to generate abnormally high profits and share them with preordained 'winners', governments indulge in crony capitalism by manipulating trade, fiscal, monetary, and regulatory policies (Menaldo, 2014). The 'losers' include medium-sized firms, unorganized labor, agricultural interests, and unorganized taxpayers and consumers. These groups subsidize protectionism by paying higher prices for low quality goods and services and they also bear the burden of bailouts of financial institutions. Markets in crony capitalism are less competitive, they intensify rent-seeking, and shortchange innovation. Crony capitalist coalitions are built on unsustainable policies that produce adverse effects and hurt a society's most vulnerable populations (Menaldo, 2014).

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2

Antecedents and Consequences of Cronyism in Organizations

Naresh Khatri and *Eric W. K. Tsang*

Introduction

Crony capitalism, the granting of economic favors to friends and privileged associates, is widely regarded as a key factor contributing to the Asian financial crisis of 1997 (*Asiaweek*, 1999; Dale, 1999). Along with collusion, corruption, and complacency, endemic use of cronyism is one of the "four Cs" believed to have allowed the business, government, and finance sectors in several Asian countries to conspire and undermine meaningful competition (Husted, 1999; Vogl, 1999). For instance, cronyism was involved when executives in Asian financial institutions extended excessive credit to customers with whom they held personal connections (*Economist*, 1998). Until the recent business malfeasance in the USA, the practice of cronyism in Western countries has drawn relatively little attention. However, the Enron debacle illustrates its practice in full form:

> Americans who came to see their free-market economy as largely immune to the cronyism that plagues many foreign countries were shocked to see how Enron's cozy ties with its own accounting firm inoculated it from scrutiny. (*Business Week*, 2002a, p. 110)
>
> (The company) "not only cooked its books. It used its extensive political influence to cook the regulatory system itself. When a public-minded chairman of the Federal Energy Regulatory Commission stood in Enron's way Chairman Kenneth L. Lay paid a call and the offender disappeared" (*Business Week*, 2002b, p. 20).

The laws passed to impose heavier penalties on such crimes did not satisfy a skeptical reader, who commented in a letter to the *Boston Globe*:

> The rush to pass tough criminal laws against America's thieving executive class is admirable but insufficient. It ignores the larger problem of a culture of unethical manipulation and shameless cronyism . . . it avoids the structural question of whether the United States should continue to be a country where the well-connected few reap incredible benefits while the majority gets crumbs, windy rhetoric, and the illusion of inclusion. (2002, p. E.8)

The USA is not alone. For instance:

> The sorry catalogue of scandal and mismanagement that has dogged French governments of both left and right is seen by citizenry as an indictment of the centralist cronyism typified by the hold on French government, civil service, and big business maintained by the graduates of the grandes ecoles—notably ENA (Ecole nationale d'administration). (Earl of Stockton, 2002, p. 41)

The above examples suggest that there is no dearth of cases of cronyism in organizations. In fact, the term "cronyism" appears frequently in the media. For instance, in a search of the Lexis-Nexis database, the term appeared 727 times in major newspapers worldwide during the first six months of 2002. Recent research also throws new light on the old expression "It's not what you know but who you know," which reinforces the importance of personal connections in organizations. A study of a large US-based company with 270,000 employees worldwide has shown that individuals who are well connected with senior executives located in corporate headquarters have higher career attainment than those who are not (Hurley et al., 1997). In an empirical study of pay allocations made by managers of a US nonprofit organization, Schoderbek and Deshpande (1993) found that, in addition to performance, managers gave significant importance to non-performance factors, such as the organizational or political connections of a subordinate. Cronyism is obviously against the principle of fair employee appraisal and is an unethical management practice. Reports of cronyism in the media are usually associated with a certain degree of moral rebuke.

In spite of it being perceived as a widespread phenomenon, cronyism as a construct has not been systematically analyzed and developed by organizational researchers. We believe that the construct of cronyism is important because its practice is extensive and consequences serious.

The objectives of this chapter are to develop the construct of cronyism and to describe the antecedents and consequences of cronyism in organizations. To start with, the next section discusses the working definition of cronyism adopted in this chapter and the nature of cronyism in the organizational context.

Concept of cronyism

Cronyism comes from the word *crony*, which originated as a piece of Cambridge University slang around the 1660s. Originally written as *chrony*, it was based on the Greek word *khronios*, meaning "longstanding." *Crony* seems to have been intended to mean "friend of long-standing" (*Dictionary of Word Origins*, 1990). *Cronyism* appeared around 1840 and its initial meaning was "the ability or desire to make friends." It came into use in political parlance when, in 1952, the Truman administration was accused of appointing friends to government posts regardless of their qualifications. A journalist on the *New York Times* described this practice as *cronyism*, so modifying the meaning of word (*Oxford English Dictionary*, 1989). Thereafter, the neutrality and innocence of the word was destroyed. With this change of meaning in *cronyism*, "crony" now often entails a derogatory sense of friendship with a trace of political corruption or preferential treatment about it.

Cronyism is a broad social phenomenon. It is important to make a distinction between two types of cronyism, namely horizontal and vertical. Horizontal cronyism occurs among peers, such as business associates, friends, and colleagues. The form of cronyism that has been blamed for giving rise to the Asian financial crisis is horizontal: cheap credit was granted excessively by financial institutions to their preferred customers (or cronies). While horizontal cronyism occurs among peers and can be intra- or inter-organizational, vertical cronyism is based on a superior–subordinate relationship within the organization. Here cronyism involves exchange of patronage downward with personal loyalty upward. The recent church crisis in the USA, for instance, has been frequently attributed to "hierarchical protection," which may suggest the presence of vertical cronyism. The following quote captures the essence of vertical cronyism nicely: "What is most important for me and my department is not what I do or achieve for the company, but whether the Master's favor is bestowed on me . . . This I have achieved by saying "yes" to everything the Master says or does . . . To contradict him is to look for another job" (Negandhi and Prasad, 1971, p. 128).

Since the dynamics underlying the two types of cronyism is quite different, this study focuses only on vertical cronyism. Thus, for the purpose of this study, we define cronyism as favoritism shown by the superior to his or her subordinate (e.g., promotion, bonus, pay raise, or better job assignment) based on non-performance (e.g., relationship of subordinate with the superior), rather than performance criteria (e.g., objective performance, competence, or qualifications of the subordinate), in exchange for the latter's personal loyalty. For example, an employee with a good performance record loses out on a promotion or pay increase because his or her superior favors another person on the basis of that person's relationship with and loyalty toward the superior. Merit thus takes a back seat in cronyism. Although the superior may unconsciously regard the relationship as more important than job performance for promotion or pay raise considerations, such an unacknowledged form of cronyism still violates the principle of fair performance appraisal in the eyes of the disinterested third party. In short, cronyism, whether acknowledged or unacknowledged, leads to similar consequences.

The nature of cronyism is proactive and dynamic. Goman (1991) notes that loyalty has two dimensions: emotional and behavioral. The emotional dimension of loyalty results from truly felt gratitude. Since emotions are invisible, one's loyalty is evaluated through the behavioral dimension. In situations where loyalty is a highly valued attribute, individuals tend to display loyal behaviors in order to receive favorable evaluations and personal benefits. Furthermore, it may not be easy to distinguish between behaviors that emerge from truly felt gratitude and behaviors that result purely from "impression management." Thus, our definition of cronyism is based on the notion of perceived loyalty. Subordinates are likely to play an active role. For instance, a subordinate may want to influence the perception of his or her supervisor by uncritically agreeing with the supervisor on work or non-work related issues or by speaking highly of the supervisor in the presence of the supervisor's immediate boss (Deluga and Perry, 1994).

Cultural antecedents

Although cronyism is likely to exist to a varying extent in organizations of every culture, certain cultural values provide a conducive environment for breeding cronyism. In particular, we argue that particularism and paternalism would lead to two immediate antecedents of cronyism: strong in-group bias and unreserved personal loyalty. Our model is shown in Figure 2.1.

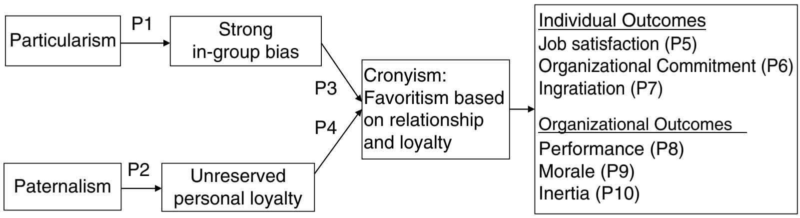

Figure 2.1 A model of cronyism in organizations

Particularism

Particularism is a way of thinking prevailing in collectivist cultures, in which the standards for the way a person should be treated depends on the group to which this person belongs (Hofstede, 1997). Collectivists view group membership as long term and permanent, and their actions center around the long-term aspect of their work group membership. Since the distinction between in-groups and out-groups is at the very root of collectivists' consciousness, treating one's friends better than others is natural and acceptable. For people with this particularistic attitude, greater attention is given to the obligations of relationships and less to abstract social rules (Trompenaars, 1993). Universalism, as the opposite of particularism, concerns the application of general rules uniformly to all. Max Weber described universalistic organizational practices in detail and labeled organizations with such practices "bureaucracies." Among other things, a bureaucracy follows impersonal, merit-based staffing policies; hiring or promoting of employees is based on an impersonal assessment of their performances and abilities. In other words, this rule of meritocracy is applied to all organizational members. On the other hand, primarily particularistic personnel practices include hiring or promoting employees because of who they are (say, in relation to certain politically powerful people in the organization), claiming performance-based pay but keeping no records of performance and providing no announcements of who received what so that pay increases can be granted to personal favorites (Pearce et al., 2000). For example, Pearce (1991) describes the practice of performance bonuses ranging from 0 to 200 percent of the base salary not accompanied by objective measures of employee performance in Hungarian enterprises. Rules, if any, are only selectively applicable, depending on the identity of the person who is supposed to be bound by the rule in question. In fact, elaborate rules with loopholes may be constructed which supervisors can use subjectively to advance their favored subordinates and to thwart others who belong to the out-group.

A consequence of particularistic thinking is the emphasis on insider contacts, in-group promotion, and actions directed at benefiting the group in a collectivist culture (Erez and Earley, 1993). Kim (1994) argues that maintenance of strong and cohesive in-groups in a collectivist culture often perpetuates in-group favoritism and ethnocentrism. A collectivist competes with out-group members, even if it is not in his or her self-interest to do so (Espinoza and Garza, 1985), and expresses hostility or communicates ineffectively with out-group members (Triandis, 1967). Sinha and Sinha (1995) note that even competence cannot substitute personalized relationship. Competent people who confine themselves to job-specific relationships are generally excluded from the network of personally related in-group members. The discussion leads to:

Proposition 1: Particularism will be positively associated with in-group bias in organizations.

Paternalism

Hofstede's (1997) study found paternalism to be closely associated with power distance, which is defined as the extent to which the less powerful members of organizations expect and accept that power is distributed unequally. In high power distance organizations, the less powerful individuals are willing to accept unequal distribution of power unquestioningly. According to Pfeffer and Salancik's (1978) resource dependence perspective, the process of power accumulation is predominantly tied to resource control so that individuals, or groups, with control over key resources will likely become very powerful within an organization. In a high power distance culture, it is relatively more acceptable for these resources to be concentrated in the hands of certain individuals than to be distributed equally. In other words, power differentials provide legitimacy for the actual, unequal distribution of resources (Earley, 1997).

Employees in a high power distance culture are at ease with the paternalistic style of management and there is no strong felt need for them to be involved in decision making (Banks and Waisfisz, 1994). They view organizational hierarchy as existential inequalities and expect to be told what to do by their superiors. In addition, their opinion of an ideal boss is a benevolent autocrat (Banks and Waisfisz, 1994; Hofstede, 1997). For example, Indian managers are found to believe that workers in their organizations do not want to accept responsibilities (Tripathi, 1995). They do not invite participation from workers thinking that doing so would be seen by workers as a sign of weakness on the part of management. Paternalistic superiors have considerable discretionary power as they are seldom required to justify their decisions openly. Furthermore, there is a greater chance for mechanistic law to give way to human judgment (Bond, 1991). Decisions are made based on the balance between favors and loyalty rather than merit (Husted, 1999).

Erez and Earley (1993) argue that a collectivist culture tends to perpetuate a paternalistic style of management in an organization that expects workers' loyalty. This paternalistic role in an employee's life is not viewed as intrusive; quite the contrary, workers expect their organization to play a significant role in their lives and expect their superiors to participate as a parental or guiding figure. The paternalistic role of the leader may seem inconsistent with the egalitarian norms of collectivists, but it would be consistent if we assume that the leader is perceived as someone who will help a group attain its goals (Hofstede, 1997). Sinha and Sinha (1995) in their study of Indian organizations note that seniors on their part must protect, help, and provide patronage and affection to their juniors. In return, they expect loyalty, compliance, and total submission by subordinates. Superiors give because they are kind; their subordinates receive because they are loyal and submissive.

Farh and Cheng (2000) propose a model of paternalism consisting of three dimensions: authority, benevolence, and morality. The model specifies three sets of behaviors for superiors and subordinates corresponding to the three dimensions. Only the first two dimensions (authority and benevolence) are relevant in the context of cronyism. According to the authors, authoritarianism is similar to *li-wei* and benevolence similar to *shi-en*. *Li-wei* consists of a superior's personal authority, dominance, and control over subordinates. Subordinates respond to the superior's *li-wei* with obedience, compliance, and submission. The concept of *shi-en*, on the other hand, refers to a superior's behaviors that demonstrate personal favors and generosity. In response to the leader's *shi-en*, subordinates feel indebted to the superior and reciprocate by showing unwavering personal loyalty and obedience to the superior. It needs to be noted that *shi-en* is different from consideration; while *shi-en* is couched in an atmosphere of respect for individuals and a spirit of egalitarianism, *it* is practiced in the context of strong authority. The superior does not let the subordinate forget who is boss and who is subordinate. This leads to:

Proposition 2: Paternalism will be positively associated with unreserved personal loyalty in organizations.

Immediate antecedents

Emphasis on personal relationships and loyalty, to a certain degree, may be functional and does not necessarily breed cronyism. Goffee and Jones (1996), for instance, argue that sociability, which refers to sincere friendliness among members of an organization, raises morale, fosters teamwork, and promotes creativity. Nevertheless, when the stress on relationships is so great that it is turned into strong in-group bias and when loyalty becomes unreserved, cronyism is likely to occur.

In-group bias

Relationships among people create the complexity of organizational life (Barge, 1994). Beneath the cloak of formal relationships in every organization, there is a more complex system of social relationships that arises spontaneously as people associate with one another. Unlike the formal structure, which emphasizes official positions in terms of authority and responsibility, the informal structure emphasizes people and their unofficial relationships (Newstrom and Davis, 1993). According to Furnham (1997), the informal system evolves to fulfill needs that cannot be met by the formal system. Developing informal relationships with the right people, who may include subordinates, peers, and superiors, can be a useful means of acquiring power (Johns, 1992). Often, such informal relationships in organizations bring about more influence and power than formal relationships (Jenks, 1990). The dyadic relationship between superior and subordinate in the context of cronyism tends to be governed by their interpersonal ties rather than contractual obligations. Such informal relationships may override organizational charts and involve an element of "power-seeking," where individuals exchange more than friendship among themselves to further individual goals that cannot be met through formal channels.

The strong interpersonal connections associated with cronyism result in the formation of "cliques" (Trice and Beyer, 1993) or in-groups which tend to be exclusive. Studies suggest that the mere act of categorizing people as in-groups and out-groups tends to result in favoritism of one's in-group (Tajfel et al., 1971; Turner et al., 1983). In the leader–member exchange model, Graen and Cashman (1975) suggest that in-group members are given high levels of trust, interaction, support, and rewards while out-group members receive low levels of each. In-group members enjoy considerable benefits while out-group members are denied valuable opportunities (Vecchio, 1997).

One key distinction between cronyism and the leader–member exchange model (Graen and Cashman, 1975) is that the distinction between in-group and out-group members is much sharper in cronyism. Such a distinction is rather ambiguous in Western societies, but very clear in certain Asian societies (Triandis et al., 1988; Goodwin and Tang, 1996). For example, Redding (1990) uses the term "personalism" to describe the strong emphasis on interpersonal relations among the Chinese. In the business arena, personalism is the tendency to allow personal relationships to enter into managerial decision making. Gabrenya and Hwang (1996) argue that personalism begins with a distinction between in-group members or insiders (*zijiren*) and out-group members or outsiders (*wairen*). Empirical studies of Chinese organizational behavior have found that Chinese superiors tend to classify their subordinates as either *zijiren* or *wairen* and to treat them accordingly (Hwang, 1990). In particular, superiors tend to be more human relation oriented toward in-group subordinates and more task oriented, even exploitative, toward out-group subordinates (Tripathi, 1995; Cheng, 1999). An empirical study conducted by Law et al. (2000) also indicates that Chinese managers usually recommend and promote their in-group members before higher level managers. This indicates that:

Proposition 3: Strong in-group bias will be positively associated with cronyism.

Unreserved personal loyalty

In discussing favoritism, patronage, and sponsorship in large organizations, Fisher (1977) states that whether in politics or business, patrons place extraordinary importance on loyalty from those they have rewarded. To expand their power and to push forward their political agendas, superiors need loyal subordinates. Indeed, the unreserved devotion and unswerving loyalty expected of employees are based on the link between patronage and gratitude (Cheng, 1999), where patronage is the act of dispensing favors to individuals regardless of their abilities (Redding and Baldwin, 1991).

For the purpose of this study, we are more concerned with the dimensions of loyalty in the Asian context which more accurately reflect the nature of loyalty in cronyism. The Asian dimensions encompass more than identification and internalization, the two Western dimensions identified by Becker et al. (1996). Chen et al.'s (1998) study found that the dimensions of loyalty to the supervisor in the Chinese context include an indigenous Chinese dimension that reflects one's personal attachment and gratitude toward the supervisor.

Some cultures (e.g., Chinese and Indian) are characterized by personalism and paternalism, suggesting that loyalty to a supervisor (person) rather than to an organization (system) plays a more important role in driving employee behavior (Redding, 1990). Chi (1999) highlights the role of *chin-shins* (confidants) who hold special positions in their superiors' relational networks. *Chin-shins* are more than in-group members; to be more exact, they are the "core" of an in-group. The relationship between *chin-shin* and superior goes beyond instrumental social exchange. A *chin-shin* perceives the superior as someone who deserves truly felt gratitude and in turn demonstrates unreserved loyalty to the superior.

It should be noted that personal loyalty toward the superior is different from loyalty to the organization or organizational commitment. As elaborated in the next section, a supervisor's cronies may not be committed to the organization. In fact, the development of a deep sense of obligation toward the supervisor may supersede attachment toward the organization (Chen and Francesco, 2000). In extreme cases, if the supervisor leaves the organization, his or her cronies will follow suit. According to the agency theory, a manager may have personal agendas that are in conflict with organizational objectives. Hence the manager's loyal cronies may not work for the best interest of the organization. In brief, the discussion suggests:

Proposition 4: Unreserved personal loyalty will be positively associated with cronyism.

Consequences

After discussing the antecedents of cronyism, we analyze how cronyism may produce certain salient consequences at the individual and organizational levels.

Individual outcomes

In this section, we examine how differential treatment toward in-group and out-group subordinates by their superiors affects job satisfaction, organizational commitment, and extent of ingratiation of subordinates.

Job satisfaction

Being trusted assistants, in-group members of a work unit tend to develop a feeling of gratitude toward their superiors. They are likely to be satisfied with their work due to the existence of affective bonds in their working relationships. For example, in the case of Chinese organizations, in-group members have more opportunities to be rewarded. Promotion speed is faster for in-group than out-group members (Cheng, 1999). The former are also more likely to be given assignments that are interesting, challenging, and with good exposure. Lagace et al. (1993) found that in-group members were higher on motivational factors and experienced less role-related stress (role overload, role insufficiency, role ambiguity, and conflict). For out-group employees who do not possess the essential connections, their level of satisfaction is likely to be lower because even if they are the "cream of the crop," their chances of climbing the corporate ladder are slim. This has an adverse impact on their sense of self-worth as they become stuck in organizations that require personal connections to "earn" promotions (Hurley et al., 1997). They are likely to feel a sense of injustice when they perceive that in-group members, regardless of capability, manage to be promoted much faster than they do. It is not surprising to find that out-group members are more likely to file grievances (Cleyman et al., 1993). Thus:

Proposition 5: In-group members will have greater job satisfaction than out-group members.

Organizational commitment

As noted earlier, employees with collectivist values commit to their organizations primarily due to ties with their superiors (Boyacigiller and Adler, 1991). In their study of organizational commitment in China, Chen and Francesco (2000) comment that the commitment shown by employees may in fact represent more of a commitment to their superiors. Since individuals are hired, allocated tasks, evaluated, and rewarded by their superiors, the former's allegiance tends to be leaning toward the latter. This may result in the development of a deep sense of obligation toward the superior, which may supersede attachment toward the organization. Such an outcome is rendered more likely in organizations with widespread cronyism, in which unreserved loyalty to superiors is stressed. In other words, in-group subordinates are likely to show low commitment to the organization. The emphasis on loyalty to the superior may translate into negative organizational performance when the supervisor's personal goals conflict with those of the organization. Pearce et al. (2000) argue that particularism works against identification with and commitment to the larger organization. Although cultural influence plays an important role here, the practice of cronyism, with its stress on loyalty toward the superior rather than the organization, greatly reinforces such influence.

Commitment is related to organizational dependability or the extent to which an organization is perceived to be looking after the interests of its employees in practices such as job security and career development (Buchanan, 1974; Steers, 1977). Owing to in-group bias, the efforts of out-group members are often unrecognized by their supervisors. Moreover, out-group members do not experience the job security and desired rewards in-group members enjoy. They are often overlooked in terms of opportunities for personal achievement. While in-group members are delegated key roles in the organization, out-group members are merely assigned peripheral functions that are easily replaceable (Cheng, 1999). Hence, they are likely to show low commitment to the organization which has failed to look after their interests. Consistent with Pearce et al.'s (2000) finding of lower trust and commitment and greater shirking in organizations with particularistic practices, we propose:

Proposition 6: Organizational commitment will be negatively associated with cronyism.

Ingratiation

Liden and Mitchell (1988, p. 572) define ingratiation as "an attempt by individuals to increase their attractiveness in the eyes of others." In the context of superior–subordinate relationships, ingratiation is one particular upward influence strategy whereby ingratiatory behaviors are driven by attempts to influence someone higher in the formal hierarchy of an organization (Porter et al., 1983).

There are various tactics of ingratiation (cf. Liden and Mitchell, 1988). In the case of Chinese organizations, common practices include claiming kinship, seeking personal ties, doing favors, keeping contact, and sending gifts (Cheng, 1999). Since loyalty is treasured in cronyism, subordinates may openly echo the boss's views and defend his or her face and prestige. They may also acknowledge the power distance in the pecking order and show their submissiveness in order to win the boss's heart (Fisher, 1977). The great tangible benefits associated with the in-group status encourage ingratiatory behaviors. Tripathi (1995) notes that the superior–subordinate relationship in Indian organizations is characterized by a great degree of dependence of subordinates on their supervisors and because of this subordinates display a great deal of ingratiation to their supervisors. Hence:

Proposition 7: Ingratiation will be positively associated with cronyism.

Organizational outcomes

In addition to having impacts on individuals working in an organization, cronyism also generates significant consequences at the group or organizational level.

Performance

There are several obvious reasons why cronyism adversely affects organizational performance. First, personal feelings can bias judgment. Larson (1984) argues that positive affect toward subordinates makes managers less likely to give them negative performance feedback. Similarly, DeCotiis and Petit (1978) maintain that supervisor–subordinate relationships are a potentially powerful contaminant of performance appraisal ratings. Vecchio and Gobdel's (1984) study found that subgroup status accurately predicted supervisor ratings but not objective performance measures. Similarly, Tripathi (1995) observed that personal relationships enter into performance evaluation in a big way in Indian organizations. In other words, in-group members might receive artificially inflated performance ratings. This implies that the perceived competence of in-group members may be an effect rather than a cause of their attainment of the in-group status (Vecchio and Gobdel, 1984; Cardy and Dobbins, 1986). Thus, incompetence among in-group members tends to be hidden and covered up in the organization.

Second, since in-group members are rewarded on the basis of loyalty rather than competence, they do not see the need to excel and may at best achieve average performance. Moreover, they tend to channel their energy and attention to ingratiating themselves with their superiors and to other related political behaviors. This distracts them from completing their proper job duties (Goffee and Jones, 1996). For example, Singh (1988) argued that those who emphasize personal relationships at work usually work less hard for two reasons. First, both time and energy are needed in nurturing relationships. Second, personal connections are utilized to dilute many of the organizational norms. As for out-group members, their motivation to perform tapers off due to the inequitable and subjective reward system (Redding, 1990). They have little incentive to exert extra effort at work. In brief, we believe that cronyism is likely to produce detrimental effects on the output levels of both in-group and out-group members.

Third, the subordination of competency to loyalty and relations may result in the dreck at the bottom, rather than the cream, rising to the top (Bedeian and Armenakis, 1998). Old and loyal employees continue to be employed, although they no longer perform their duties effectively (Farh and Cheng, 2000). Talent, which would otherwise rise to the top, is blocked and stifled by lack of opportunity. This leads to talented people leaving the organization. The constant leeching away of talent inevitably weakens the strength of the organization (Redding and Hsiao, 1993).

Finally, quality of decision making is a victim of cronyism. In describing the "primitive" Asian-style corporate culture, considered a contributing cause of crony capitalism, it is said that "senior managers are always right even when they are wrong, and usually take it affront when contradicted (even correctly) by their juniors; and the best way for employees to survive is to say the expected thing" (*Business Times*, 1999, p. 7). Managers who are surrounded by "yes men" are unable to benefit from the diverse perspectives, experience, and knowledge of their subordinates. Worse still, with stress on conformity, ideas are unlikely to be refined and improved through group discussion and debate. Hence:

Proposition 8: Organizational performance will be negatively associated with cronyism.

Morale

While job satisfaction is a personal matter based on each individual's value system and attitude toward the job, morale is a group concept – a composite of all individuals' job satisfactions (Benton, 1998). Some studies on leader–member exchange have found that in-group members receive more attention and support from their superiors than out-group members (Scandura, 1999). Since in-group exchanges have the characteristic of a partnership, the interactions between supervisors and their cronies are governed by interpersonal relationships rather than formal authority (Berry, 1998). In-group members are likely to experience high morale, which results from the building of such intimate personal relationships (Jenks, 1990). Their morale is also boosted by their ability to derive tangible benefits, such as higher pay increases and faster promotions, from the exchange relationships with their supervisors.

On the other hand, out-group members only receive the standard benefits from the formal relationships with their superiors. The result of having such differentiated treatment can cause hostility between the two groups, thus adversely affecting their cooperation and sense of teamwork. Gradually, the relation between the in-group and out-group subordinates suffers as the unjustified practices continue – the leader's cronies are perceived to be getting more benefits than deserved (Yukl, 1994). Over time, the morale of the out-group will be eroded by their feelings of alienation, powerlessness, and inequity as favoritism of in-group employees renders the relationship between performance and reward less obvious (Prendergast and Topel, 1996).

In a collectivist setting, in-group loyalty often leads to out-group derogation, and in-group cooperation is often coupled with fierce out-group competition. Strong and cohesive in-groups usually perpetuate factionalism (Kim, 1994). The situation can become so political that individuals and cliques spend much of their time pursuing personal agendas (Redding, 1990; Goffee and Jones, 1996), and on advancing their own interests at the expense of others. Political behavior is usually associated with conflict (Drory and Romm, 1990). The fact that organizational resources are limited implies that cliques need to fight bitterly against each other in order not to lose out. This hampers the development and promotion of norms, rules, harmony, and trust in the organization. A likely result is a fragmented organization with low overall morale.

Proposition 9a: Morale of the in-group will be higher than that of the out-group.

Proposition 9b: Overall morale will be negatively associated with cronyism.

Inertia

Redding and Baldwin (1991) suggest that high power distance generally leads to a stable organizational structure, the subtleties of which are often visible only to its members. Indeed, because of subordinates' submissiveness and unquestioned acceptance of unequal distribution of power, key personalities who are in control face little or no threat (Blunt, 1993). In other words, stability is ensured through little turnover of those who are in power.

While centralized control and obedience from subordinates provide political stability to the organization, they also give rise to organizational inertia. Indeed, owing to overemphasis on conformity and a high level of incompetence, the growth of the organization and its full potential to adapt to changes will be restricted. Stress on conformity and centralized control prevents an organization from learning by limiting initiative and innovation from below (Stata, 1989; Redding, 1990). Information collected by subordinates who are in touch with customers, suppliers, and other outside stakeholders may fail to reach their superiors. Thus, while cronyism serves to strengthen the grip of a few at the top of the organization, it imposes a constraint on the organization's ability to learn and adapt to changes.

Proposition 10: Organizational inertia will be positively associated with cronyism.

Discussion and Conclusions

In this chapter, we have defined cronyism and developed propositions on its antecedents and consequences. The two cultural values, namely particularism and paternalism, give rise to the two immediate antecedents, in-group bias and unreserved loyalty. The effects of cronyism, whether at the individual or organizational level, are far-reaching. From the perspective of in-group members, cronyism is desirable as it entails higher pay increases and faster promotions. However, organizational performance may be in jeopardy once cronyism penetrates the organization. We believe that organizations riddled with cronyism are unlikely to be efficient and be able to survive in a competitive environment.

We have highlighted the reciprocal relationship between superiors and their cronies. In order to achieve desired rewards, cronies need to exhibit attributes that their superiors favor. Despite being able to obtain the desired ends, cronies do not necessarily perform better than noncronies. This is because cronies know very well that their success does not rely on their competence, or rather the lack of it, alone. This outcome contradicts the normal prediction of equity theory that employees will try to improve their job performance when they receive very favorable treatment at work. Of course, it remains to be tested empirically whether such a violation of equity theory really holds.

Generalizability

As long as some of the antecedents of our model are present in an organization, cronyism will likely be found. For example, an investigation report describes the state police of Massachusetts as a listless and poorly trained force riddled with cronyism (*Boston Globe*, 1996). Institutions such as the army and the police are known for a paternalistic/authoritative style of management emphasizing obedience, conformity, and submission to higher authority. It comes as no surprise that an overwhelming majority of troopers surveyed by the above investigation report complained that loyalty, not merit, motivated assignments and promotions in the state police. Similarly, the history of the Federal Bureau of Investigation (FBI) is marked with charges of cronyism (*Washington Post*, 1995). In another example, the entire European Commission, the main administrative body of the European Union, had to resign after the disclosure of a devastating report of cronyism and corruption in its management. In particular, the former French Premier, Edith Cresson, who was head of the education and research department, was accused of practicing favoritism in the recruitment of staff (*Hindustan Times*, 1999). It is interesting to note that French culture is high on power distance, which is closely related to paternalism. A further stark example of blatant and widespread cronyism was the regime of the former Indonesian President Suharto. It was established that "[u]nder his patronage, jobs were awarded on the basis of personal loyalty" (*South China Morning Post*, 1999, p. 20). It should be noted that Indonesian culture is high on particularism and power distance.

Variants of cronyism

From the above examples we see that there is no dearth of cases of cronyism in organizations, whether in Asia or in the West. To assess the applicability of the model, we need to look at two basic elements that constitute cronyism in the model: strong in-group bias and unreserved personal loyalty. Whenever there is strong in-group bias or emphasis on unreserved loyalty or both in an organization, cronyism is a likely outcome. The strength of cronyism will be determined by the strength of in-group bias and loyalty orientation. It is not necessary for both factors to be present to cause cronyism. The presence of one factor, if sufficiently strong, can lead to cronyism, although classic crony behaviors in organizations will be observed in organizations where both in-group bias and loyalty orientation are strong. This brings us to the notion of variants of cronyism; that is, crony behaviors observed in Asia and the West may be somewhat different. Although loyalty is a desirable attribute in all cultures, it has a much loftier position in Asian societies (Earley, 1997). Loyalty will not be desired and rewarded in the Western context to the same degree as in the Asian context. The other element of cronyism, strong in-group bias, can occur in all sorts of cultures and organizations, though the underlying dynamics are likely to be different from one culture to another. For example, in collectivist cultures, the relationship of the individual to the in-group is stable. Even when the in-group makes harsh demands on the individual, the latter tends to stay with the group. The individualist, on the other hand, belongs to multiple in-groups and has a tendency to change group membership and status (Triandis et al., 1988). The other major difference lies in the goal of in-group membership. In the West, membership is likely to be based mostly on instrumental considerations. In Asian cultures, in-groups serve many purposes, such as providing emotional support, protection, and instrumental gains.

Moderating factors

If cronyism has dysfunctional consequences as discussed above, it will be useful to identify factors that can mitigate its prevalence and influence on behaviors in organizations. We can think of three plausible moderating factors that are likely to result in less frequent crony behaviors: a competitive business environment, formalized and transparent reward systems, and competent bosses. A firm riddled with cronyism inside is unlikely to produce the economic results that enable it to survive in a highly competitive business environment. In other words, the pressure of competition will drive out cronyism. Goffee and Jones (1996) found in their research that, over the previous decade, many large well-established companies with strong traditions of loyalty were forced to change because of increased competition. Further, cronyism stems from the fact that superiors are able to manipulate rewards and punishments for their subordinates. The greater their ability to do so, the greater the personal dependence of subordinates on them. Messick (1998) maintains that preferential in-group treatment may be reduced by making evaluation criteria explicit, objective, and public. Lastly, presence of competent superiors is likely to reduce crony behaviors. It is intuitive that competent superiors tend to reward and promote competency among their subordinates. On the other hand, incompetent supervisors would feel threatened by competent subordinates and inevitably drive away competent employees (Bedeian and Armenakis, 1998). Prendergast (1993) notes that "yes men" tend to be concentrated among less able workers and among workers with less able managers. Similarly, Downs (1967, p. 71) states that personal loyalty to one's superior "stems from the rarely discussed fact that all top-level officials (and many others) are frequently in danger of being embarrassed by revelations of their acts, failures, lack of control over their subordinates, and sheer incompetence."

Limitations and directions for future research

We have presented a conceptual model without the support of empirical studies. In a way, it is a broad thesis and the verdict is not out yet. A challenging extension of our research is to examine antecedents and consequences of cronyism empirically in various cultures. Only then will the propositions of our model be tested across cultures. Another future research direction is to examine empirically the model in private and government sector organizations with a hypothesis that cronyism will be more serious in government organizations.

We include only two cultural antecedents in the model. Further research may examine whether other cultural dimensions, such as uncertainty avoidance, will add to the predictability power of the model. There are many other ways that our model can be further developed and refined. Some fruitful research questions are: How do superiors select their cronies? How does the relationship between superiors and their cronies evolve over time? What is the impact of the relationship between superiors and their immediate bosses on the former's relationship with their cronies? Can cronyism flourish in certain sections of the organization only, but not in others? What is the group dynamics among in-group versus out-group members?

As argued above, there may be variants of cronyism. We suspect that, for instance, cronyism in Western cultures is less loyalty oriented and more based on instrumental relationships when compared to that found in Asian cultures. Of course, our conjecture has to be substantiated by further research. In conclusion, our model is the first step toward investigating an interesting yet largely unexplored phenomenon in organizations. A lot more research effort is still needed.

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3
Cronyism: A Cross-Cultural Analysis

Naresh Khatri, Eric W. K. Tsang, and *Thomas M. Begley*

Introduction

The Asian financial implosion of 1997 brought opaque business transactions to the forefront in many countries affected by it. A purported primary contributor to the crisis was the reportedly widespread practice whereby executives in Asian financial institutions funded questionable business transactions by family and friends (Chiu and Joh, 2004; Pagano, 2002, 2003; Waldron, 2002). One of a host of similar acts of kinship patronage collectively labeled crony capitalism, this practice subverted economic competitiveness as banks that failed to price their loans based on credit risk received poor returns from large segments of their portfolios (*Asiaweek*, 1999; *Economist*, 1998).

The practice of cronyism in Western countries has drawn relatively little attention. However, the recent corporate governance crisis in the USA has arisen from a magnitude of corporate malfeasance that suggests a need for in-depth examination of systemic features (Adler, 2002). Davis argued that the US economic system has evolved its own brand of crony capitalism:

> Far from being a system characterized by impersonal, calculative relationships, the American corporate system is thick with social connections among the most important decision makers. Corporate directors and the executives they oversee, financial analysts, investment bankers, and state legislators responsible for creating corporate law, are tied together in a dense network that contrasts sharply with the theory of an anonymous market policed by independent analysts, auditors, and legislators. (2003, p. 40)

We view cronyism as a prime contributor to the difficulties that lie at the core of the crisis in corporate confidence.

In beginning to recognize its importance, scholars have recently compared cronyism with macroeconomic and financial variables as predictors of economic performance under certain conditions (Bjorkman and Kock, 1995; Nef, 2001; Pagano, 2002, 2003; Steidlmeier, 1999; Waldron, 2002). For example, in examining the Asian financial crisis, Pagano (2002, p. 229) concluded: "We find that . . . "cronyism" . . . is the most significant variable influencing an East Asian country's: (1) economic recovery time from the crisis, and (2) change in the country's exchange rate during the crisis period. This factor dominates the effects of monetary and fiscal policies, as well as other important macroeconomic variables." In a Western context, Brick et al. (2002) found support for their "cronyism hypothesis" that "excessive compensation" of CEOs and their board members predicts subsequent low performance by their companies.

While the emerging literature shows cronyism's promise, it lacks precision in defining the construct and relies primarily on surrogate measures. Further progress requires a definition that captures its essential elements, contributes to its operationalization, and provides the basis for empirical studies. In this chapter, we define cronyism, distinguish it from related constructs, develop propositions on its likelihood across cultures, and advance a typology using Triandis's (1995, 1996) cultural syndromes and Fiske's (1991, 1992) relational models.

Conception of cronyism

Our conception of cronyism is rooted in social exchange theory which treats social relations among actors as the primary unit of analysis. The frameworks proposed by Homans (1961), Blau (1964), and Emerson (1972a, 1972b) form the foundation of contemporary social exchange theory. Homans (1961) believed that social group dynamics can be explained by propositions about individuals interacting with other individuals to exchange resources. As the most psychological in focus, Homans's theory received criticism for conceiving society as the sum of individual exchanges and assuming rather than explaining the larger social structures within which individuals interact (Cook and Whitmeyer, 1992). By contrast, Blau (1964), in seeking to explain social exchanges occurring among organizations and institutions, argued that social structures have emergent properties not found in collections of individual exchanges and that norms and shared values regulate patterns of indirect exchange in complex systems. Emerson (1972a, 1972b) used social relations in networks to bridge levels of analysis, arguing that actors could be either individuals or corporate groups working through agents.

An important concept in social exchange theory is the norm of reciprocity (Gouldner, 1960), which specifies that if one actor fulfills status duties to another, the other is obligated to respond in kind. This norm has a powerful influence on those who grant the favor as well as those who receive it (Veiga et al., 2004). In this manner, the sentiments of gratitude and rectitude coalesce, making reciprocity a natural behavior. Gouldner (1960) suggested that the norm of reciprocity, while universal, functions distinctly in different cultures. For example, whereas it is overt and powerful in the *compadre* system that governs almost all relations in the Philippines, the norm is relatively weak in the USA as friendship relations are less institutionalized.

We define cronyism as a reciprocal exchange transaction where Party A shows favor to Party B based on shared membership in a social network at the expense of Party C's equal or superior claim to the valued resource. For cronyism to be present, four elements must exist. First, a reciprocal exchange transaction (Emerson, 1981) involves an act by Party A to give something of value to Party B without knowing when or if B will reciprocate, or to reciprocate an earlier favor given by B. At the time of the initial act, reciprocation is implicit, its terms are unspecified, and it is expected to take place at some future point. The act may be an initial overture toward an exchange relationship or one of many in a long history of exchanges. Second, favor must be shown such that Party B receives something of value from Party A, whether tangible (e.g., a promotion) or intangible (e.g., information). Third, shared membership of two parties in a social network – based on kinship, friendship, ethnicity, religion, school, workplace, mutual interest, or another grouping category – forms the basis of the favoritism. In other words, cronyism is a kind of favoritism based on social network ties. Finally, a cronyist exchange between Parties A and B comes at a cost to Party C, who is denied the valued resource despite holding an equal or superior claim to it.

A front-page article in the *Wall Street Journal* (2003) illustrates the meaning of cronyism. When Michael LaBranche agreed to merge his firm with a smaller rival to create the largest "specialist" firm on the New York Stock Exchange (NYSE) trading floor, he needed the approval of NYSE chairman, Richard Grasso. Much to LaBranche's surprise, Grasso strongly suggested that Robert Murphy, the head of the smaller rival, be named chief executive of the merged firm. Murphy, Grasso's longtime friend and booster, needed to head a specialist firm to retain his seat on the NYSE board. As a member of that board, he had voted to approve Grasso's contract, which included among its benefits a $139.5 million payout for retirement compensation. This example presents a reciprocal exchange transaction in which Grasso showed favoritism to Murphy in apparent exchange for an earlier favor. The two shared membership in the governing body of the NYSE as well as friendship ties. Finally, Murphy gained at LaBranche's expense.

Although cronyism may be tolerated in some cultures, it raises societal costs by creating inefficiencies from unfair competition. In addition, it reduces trust in societal institutions and encourages narrow self-interest among citizens. In ethical terms, cronyism violates utilitarian ethics by failing the requirement that an act should lead to the greatest good for the greatest number. In deontological terms, it violates people's right to fair, impartial, and equitable treatment. (For similar arguments in a related area, see Dunfee and Warren, 2001; Fan, 2002.)

Comparison with similar constructs

To avoid ambiguity, we distinguish cronyism from three related concepts, namely corruption, nepotism, and *guanxi*. Representative of the scholarly literature and legal statutes of different countries, Macrae (1982) defines corruption as an arrangement that involves "an exchange between two parties . . . which (i) has an influence on the allocation of resource either immediately or within a very short time in the future; and (ii) involves the use or abuse of public or collective responsibility for private ends" (p. 678). Corruption has been used as an all-encompassing classification for abuses of power that range from complex, indirect, and subtle transactions based on mutually reinforcing ties to isolated, simple, and unilateral transactions by individuals.

We treat cronyism as a subset of corruption found in social networks characterized by complex, indirect, and mutually reinforcing social exchanges. Emerson (1981) distinguished between two types of direct exchange, negotiated and reciprocal. In negotiated exchange, two parties explicitly agree on the terms of the exchange and each party's benefits are readily apparent. In reciprocal exchange, one party initiates an exchange without knowing when, if, or how much a second party will reciprocate. While corruption includes both negotiated and reciprocal exchanges, we conceive of cronyism as exclusively a reciprocal exchange: a particularized favor based on an emergent or existing social relationship between the parties, with an implicit, unspecified return obligation. In fact, cronyism may involve an indirect or generalized exchange rather than a direct one (Levi-Strauss, 1969). In a generalized exchange, the recipient of the favor may not even reciprocate to the giver but rather to another party in the network (e.g., Molm, 1994).

The online *Oxford English Dictionary* defines nepotism as "the practice, on the part of the Popes or other ecclesiastics of showing special favor to nephews or other relatives in conferring office." Today the term is used to refer to the employment of relatives in the same organization (Ford and McLaughlin, 1986). Since it exhibits the four defining features of cronyism, that is, reciprocal exchange, favoritism, shared network, and cost to a deserving party, in the context of kinship relations, nepotism is revealed as cronyism specific to family members.

Guanxi's literal meaning is "connection" or "relationship." *Guanxi* involves a flexible but relatively permanent set of exchange relationships based on reputation and trust that provides access to resources and information over an indefinite period of time (Lovett et al., 1999; Standifird and Marshall, 2000). Participants in *guanxi* cement their ties through exchanges not only of material objects or special favors but also of respect and affection.

Similar to cronyism, the exercise of *guanxi* results in a reciprocal exchange where favor is shown within a shared network. However, three features distinguish *guanxi* from cronyism. First, in the traditional, strongest form of *guanxi*, obligations are inherited (Dunfee and Warren, 2001), whereas cronyistic obligations generally do not pass from generation to generation. Second, *guanxi* may lead to favoritism but it is not itself favoritism. Cronyism, on the other hand, is the act of favoritism itself. Finally, the benefits derived from *guanxi* do not necessarily come at the expense of other parties. For example, if Party A babysits for Party B's child and later B takes A's mother to the doctor as part of their *guanxi*, no harm occurs to an outside party. Similarly, friends may exchange gifts every Christmas without hurting anyone else's interests.

Nevertheless, exchange transactions based on *guanxi* can involve cronyism (see Fan, 2002). For instance, by 1995, Oei Hong Leong, the boss of Hong Kong–listed China Strategic Holdings, had taken majority control of nearly 200 factories previously owned by local or provincial governments in China. Oei's critics contended that through his close *guanxi* with top officials, he was able to take short-term profit without fulfilling the national objective of rehabilitating these factories (Paisley, 1995). In short, equating *guanxi* with cronyism is akin to equating networking in Western popular usage with cronyism. Moreover, its idiosyncratic features make *guanxi* hard to generalize beyond Chinese culture.

Variants of cronyism

Early theorists depicted social exchange as a process that involved rational, self-interested, cost–benefit calculations focused on optimizing outcomes (Molm and Cook, 1995), where preferential treatment arose from the giver's anticipation of benefits. More recently, scholars have challenged this conception (Lawler and Yoon, 1998; Uehara, 1990), emphasizing instead relational features such as social support (Uehara, 1990), trust (Ekeh, 1974), and group cohesion (Lawler and Yoon, 1998). In this approach, favoritism springs more from mutuality in relationship building than from narrow personal gain. For instance, Party A gives a favor to Party B based on their friendship even though the chance of receiving a reciprocal favor of similar value is clearly remote. Such a transaction is not likely to occur under the first conception of social exchange because the reciprocal favor takes priority over friendship. Both approaches, representing alternative motives for exchange, contribute to our formulation of cronyism.

We distinguish between two motives for cronyism, instrumental and relational. Instrumental cronyism is motivated primarily by task, utilitarian, and self-interest-based factors. Favors of comparatively equal value are exchanged, with reciprocation taking place in a relatively short time. The above-mentioned example involving NYSE chairman, Richard Grasso, shows instrumental features. Relational cronyism is motivated primarily by relationship, affection, and loyalty-based factors. Favors exchanged are not necessarily equal in value, with the possibility of reciprocation after an extended period of time. For example, Anwar Ibrahim and Kamaruddin Jaafar became close friends when they were schoolmates at the Malay College (Gomez and Jomo, 1997). When Anwar later became deputy prime minister of Malaysia, Kamaruddin's company obtained preferential treatment on government-awarded contracts based on that friendship (Johnson and Mitton, 2003). In other words, this relationship was not formed with any instrumental goals in mind. Subsequent preferential treatment was based on long-term friendship, affection, and loyalty rather than purely pragmatic considerations.

A core element of social exchange theory is the proposition that the relative power of the parties influences the dynamics of the exchange (Emerson, 1972b). When one party has power over another, a dependence exists that is not found when power is equal. Hence, as an expression of a power dependence relationship, cronyism has two variants – peer and hierarchical. Peer cronyism occurs among business associates, friends, and colleagues where relative equality of power exists.

Such equality ensures that each party can expect to influence the outcome of exchanges. While Party A may be highly dependent on Party B for a valued good in a particular transaction, Party B's exercise of power is tempered by the awareness that next time the dependence may well go in the opposite direction. For example, in Hallock's (1997) study of 9,804 director positions in the largest companies in the USA, CEOs who were reciprocally interlocked with other CEOs via their boards of directors could raise their compensation above those of counterparts who were not interlocked.

Hierarchical cronyism involves an exchange of favors where an imbalance of power exists between two parties. Due to this imbalance, the parties' contributions to the relationship are likely to be differentiated and the more powerful party has greater freedom to govern the terms of the exchange. Such a power differential is common in the relationship between a superior and subordinates. For example, the *Boston Globe* (1996) described the Massachusetts state police as a listless, poorly trained force where loyalty to the boss, not merit, motivated assignments and promotions.

Any act of cronyism can be depicted as a combination of motives and power relationships. When we formulate a 2 × 2 matrix based on these dimensions, four variants of cronyism emerge, peer instrumental, peer relational, hierarchical instrumental, and hierarchical relational. In the next section, we briefly examine why cronyism arises, then we identify cultural syndromes and relational models that allow us to predict the likelihood of each variant across cultures.

Cronyism across cultures

Why do people give preferential treatment to others? A recent theory on social relations that has drawn comparisons to Marx and Freud for its breadth and elegance is Fiske's (1991, 1992) relational models theory. A basic premise of this theory is that "people are oriented to relationships as such, that people generally want to relate to each other, feel committed to the basic types of relationships, regard themselves as obligated to abide by them, and impose them on other people (including third parties)" (Fiske, 1992, p. 689). Using Fiske's model, we argue that cronyism originates from people's basic desire for sociability and deep need to belong to social groups. The desire to build and strengthen relationships is a fundamentally human act. In attempting to please others, people presented opportunities to show favor naturally want to do so.

The norm of reciprocity obligates those who receive favors to return them. In Veiga et al.'s (2004) study on why managers bend company rules, an executive captures the essence of this norm: "Realistically, if someone helps you in important ways, say, getting a stalled project off the ground or in gaining access to the right individuals, it is often an unspoken rule that down the road you may have to reciprocate. I am not talking anything illegal here, just the expectation that you owe this person a debt that could include being flexible when they have a need" (p. 87). This debt leads people to want to favor certain individuals even if such favor might be unfair to others.

Culture affects cronyist behavior because it defines when and how people are expected to favor significant others. Earley and Gibson (1998), lamenting reliance on simplistic models of culture, assert the need for precise conceptual arguments to predict when cultural effects will produce specific behaviors. Adopting a contingency perspective (e.g., Chen et al., 1998; Sully de Luque and Sommer, 2000), we argue that cronyism will vary in likelihood across two cultural dimensions, individualism–collectivism and verticalness–horizontalness, as will its specific types. In the following sections, we first advance propositions on the likelihood of cronyism along the two dimensions. Then we map Triandis's (1995, 1996) cultural syndromes and Fiske's (1991, 1992) relational models onto the four-cell typology of cronyism identified previously.

Individualism–collectivism

Individualism–collectivism, the most researched cultural dimension in the field of management, is arguably the best means to measure value differences across cultures (Ralston et al., 1997, 1999; Triandis, 1996). Triandis (1995) summarizes differences along this axis through four contrasts: (a) individualists define the self as an autonomous entity independent of groups; collectivists define themselves through their connectedness to groups; (b) individualists have personal goals that may or may not overlap with those of their in-groups and deem that personal goals should take priority over group goals; collectivists have personal goals that overlap with those of their in-groups and tend to subordinate personal goals to group goals; (c) individualists' social behavior is driven by individual beliefs, values, attitudes, and interests; collectivists' social behavior is governed by social norms, duties, and obligations; and (d) individualists seek task achievement, even at the expense of relationships; collectivists value harmonious relationships, sometimes at the expense of task accomplishment.

Since collectivists prefer to handle business exchanges through someone they know (Alston, 1989), social networks encompass economic relations within personal relationships (e.g., *guanxi* in China, *wa* in Japan, and *inhwa* in Korea).[1] For example, *guanxi* has frequently served as a prerequisite to the conduct of business in Chinese communities (Tsang, 1998). In individualist cultures, business exchanges do not require, nor must they lead to, close personal relationships. Thus, while desirable in individualist cultures, relationships are more necessary in collectivist cultures.

Collectivist cultures value in-group relationships based frequently on kinship or other ascriptive ties. Since members feel obliged to take care of one another, they feel duty-bound to allocate rewards more generously to in-group than out-group members (e.g., Earley, 1989; Gomez et al., 2000; Leung and Bond, 1984; Triandis, 2002); otherwise, they may face group sanctions (Earley and Gibson, 1998; Hofstede, 1997; Hwang, 1987; Triandis, 1995). Since cronyism involves showing favor based on relationships, its practice is closer to the norms for in-group exchange in collectivist cultures. It may arise as members undertake to fulfill mutually reinforcing exchange obligations. Therefore:

Proposition 1: Cronyism is more likely to occur in collectivist than individualist cultures.

Verticalness–horizontalness

Triandis (1996) argues that verticalness–horizontalness is a particularly important cultural dimension that embodies the idea of individuals as similar to or different from one another. This dimension has gained increased attention in recent years (e.g., Kurman and Sriram, 2002; Nelson and Shavitt, 2002; Soh and Leong, 2002; Tjosvold et al., 2003). Although Triandis treats it as supplementary to individualism–collectivism, we believe that its close correspondence with Hofstede's (1997) value of power distance supports its use as an independent dimension. Vertical cultures assume that people are different from one another, take hierarchy as a given, and accent status differences as well as respect for authority. Horizontal cultures value equality, see people as similar to one another, and therefore as interchangeable, and minimize status and authority distinctions (Nelson and Shavitt, 2002).

Since people in horizontal cultures do not easily submit to authority, those whose interests are hurt by favoritism may voice grievances, which are likely to receive support from others because deprivation violates the principle of equality. Thus, horizontal cultures provide checks and balances that help prevent preferential treatment. For example, as a horizontally oriented culture, Denmark embraces a political ethos of equality enacted by safeguards against authoritarian diktat (Nelson and Shavitt, 2002). In Israel, another horizontal culture, Knesset Interior and Environment Committee chairman, Yuri Shtern, made a private plea in June 2004 to the upper echelons at the Ministry of the Interior that billionaire Shari Arison's personal chef be allowed to enter the country without a work permit. A minister without portfolio, Gideon Ezra, who brought the incident to the public's attention, objected indignantly that such favoritism stood in stark contrast to the experience of a farmer whose work permits for foreign workers had been approved three months earlier but the workers still had not been supplied (Lavi, 2004).

The emphasis on status in vertical cultures propels intense competition for high prestige positions and symbols. The notion in the USA of fulfilling the American Dream through upward social mobility is an example of a vertical value. The primacy of power dynamics and acceptance of hierarchy reduces the chance that any grievances raised by deprived parties will be taken seriously by others (Davis and Ruhe, 2003; Husted, 1999). In a pattern noted in US organizations (Hurley et al., 1997), for instance, superiors establish personal power bases by granting favors such as fast promotion to subordinates in exchange for cooperation and support. Such acts of consolidating power are considered natural and may not be scorned. On the other hand, in horizontal cultures, people high in an organizational hierarchy may not be perceived as much different from those below other than having greater decision-making responsibility. Thus, showing loyalty and deference to superiors for their patronage is not an attractive proposition for subordinates. Superiors also are not keen on cultivating loyal, obedient, and submissive subordinates as a means of developing a personal power base within the organization because exercise of power for personal gain is detested.

Through their concerns for status, authority, and difference, verticalists want to ensure that decisions regarding resource allocation are made by those in positions of power. In contrast, through their concerns for equality, personal power, and similarity, horizontalists want to ensure such decisions are made by those who know the limits of their power and subject their decisions to scrutiny. Cronyism involves showing favor to some at the expense of others. Competition in verticalist cultures pressures individuals and groups to engage in cronyist practices when pursuing success. Verticalists are better positioned than horizontalists in this respect because of the power and privilege they are granted over matters that are carefully monitored by horizontalists (Davis and Ruhe, 2003; Husted, 1999). For instance, cronyism may arise in vertical cultures as authorities seek to take care of loyal subordinates and associates. This practice is likely to be checked and disapproved in horizontal cultures. Therefore:

Proposition 2: Cronyism is more likely to occur in vertical than horizontal cultures.

Corollaries to Propositions 1 and 2

We deduce the following two corollaries from Propositions 1 and 2:

Corollary 1: Cronyism is most likely to occur in vertical collectivist cultures.
Corollary 2: Cronyism is least likely to occur in horizontal individualist cultures.

For Corollary 1, executive privilege under competitive conditions combined with in-group obligation in a collectivist environment orients vertical collectivist cultures toward the highest levels of cronyism. For Corollary 2, by contrast, lesser regard for relationship maintenance along with vigilant scrutiny of conditions to ensure equality orients horizontal individualist cultures toward the lowest levels of cronyism. Although Transparency International's annual index of corruption includes non-cronyist forms, it suggests empirical support for these corollaries. In the index, vertical collectivist countries such as Indonesia and Bangladesh rank among the most corrupt and horizontal individualist countries such as Finland and Denmark rank among the least.

Connecting cultures, relational models, and cronyism

Cronyism differs across cultures not only in likelihood of occurrence but also in its manifestations. We posit that Triandis's (1995, 1996) cultural syndromes work through Fiske's (1991, 1992) relational models to predict the most likely type of cronyism in particular cultural configurations. The 2 × 2 cultural matrix of individualism–collectivism with verticalness–horizontalness proposed by Triandis maps onto a parallel 2 × 2 matrix constructed from Fiske's four relational models. The correspondence of these two matrices with the 2 × 2 typology of cronyism enables us to better understand why a specific type of cronyism may be most likely to occur in each cultural configuration.

Triandis (1995) has strongly advocated using the cultural matrix of individualism–collectivism with verticalness–horizontalness to increase understanding of cross-cultural phenomena. In the last few years, several researchers (e.g., Chiou, 2001; Gouveia et al., 2003; Kemmelmeier et al., 2003; Nelson and Shavitt, 2002; Thomas and Au, 2002) have demonstrated its explanatory value. For example, Nelson and Shavitt (2002) attributed differences between Denmark and the USA, two individualist cultures, to their divergent positions on the vertical–horizontal axis. Since Americans value rank and status more highly than Danes, they place greater emphasis on goal achievement. Kemmelmeier et al.'s (2003) seven-country study provided greater discrimination than previously existed when it reported that authoritarianism varied along verticalness–horizontalness while social dominance varied along individualism–collectivism. We believe this matrix, in combination with Fiske's (1991, 1992) relational models theory, offers opportunities for greater specificity in analyzing cronyism.

Fiske's (1991, 1992) theory has generated a large and diverse body of research in the last decade (see Haslam (2004) for a review). He identified four elementary models of social relations which represent systematic ways people view the social world and behave toward one another (Forsyth, 1995). All the models—communal sharing, authority ranking, equality matching, and market pricing—exist within each society, but they vary in relative importance as well as specific manifestations (Earley, 1997). Relational models theory provides a framework for thinking about social exchanges beyond the mechanisms of hierarchy and markets that have framed most organizational thinking. Since the relational models are independent of the unit of analysis, they provide an opportunity to link cultural-level to individual-level constructs (Chanchani and Theivanathampillai, 2001; Earley, 1997).

In communal sharing, group members are entitled to share resources according to need. Since the basic desire of members is to belong and be the same, they emphasize harmonious relations based on intimacy, nurturance, altruism, caring, selflessness, generosity, sharing, and concern for others. In authority ranking, resources are divided according to rank, the self is either exalted or humbled, and inequality is natural. Authority ranking emphasizes respect, deference, loyalty, and obedience, with punishment for the impertinent. In equality matching, resources and work are shared equally, justice means equality, reciprocity in kind is very important, and the self is like every other self. The basic motivation is to achieve an even balance. Finally, in market pricing, each person receives resources commensurate with his or her contributions – the more you give, the more you get. Social relations are analyzed according to a calculus of profit and loss, gifts are given according to previous contributions to the relationship, and achievement is important.

Several cross-cultural scholars have posited a relationship between Triandis's cultural syndromes and Fiske's relational models (Triandis, 1995, 1996; Triandis and Gelfand, 1998; Vodosek, 2003). For example, Triandis and Gelfand (1998) noted that individualism corresponds to market pricing, collectivism to communal sharing, verticalness to authority ranking, and horizontalness to equality matching. Although the suggested correspondence has received empirical support (Koerner and Fujiwara, 2000; Vodosek, 2003), scholars have not clarified whether the two schemes are duplicates, correlates, or elements in a causal chain. Earley (1997) and Vodosek (2003) hold that Fiske's relational models mediate the impact of Triandis's cultural syndromes on individual and group behaviors. In the present chapter, we posit a causal chain in which the relational models mediate the impact of the cultural syndromes on cronyism. Further, we claim that each cell in each matrix has a corresponding cell in the other matrices. The posited relationships are depicted in Figure 3.1.

As Figure 3.1 shows, the primary relational models used in horizontal individualist cultures are equality matching and market pricing. Equality matching emphasizes fairness and balance in social relations where reciprocity among equals is stressed. In market pricing, people voluntarily enter into exchanges on often explicitly negotiated terms, paying as little as possible based on their profit and loss calculations. In cultures where equality matching combines with market pricing, the variant of cronyism most likely to emerge is peer instrumental. As Corollary 2 indicates, this cell should see the least cronyism of any cultural configuration. Whereas market pricing's calculative achievement orientation pushes toward unemotional self-interest, equality matching's concern for justice among peers runs counter to favorable treatment of any sort.

The underlying social relations patterns in vertical individualist cultures are authority ranking and market pricing. In authority ranking, individuals emphasize status differences and regard inequality as natural. Lower ranking members show loyalty and respect to their seniors through submitting to their wishes. When market pricing and authority ranking combine, calculative, achievement-oriented individuals aspire to higher status through deferring to the wishes of superiors in an attempt to secure resources. Market pricing's emphasis on measured contributions as the basis for reward tempers superiors' willfulness. In such cultures, the variant of cronyism most likely to emerge is hierarchical instrumental.

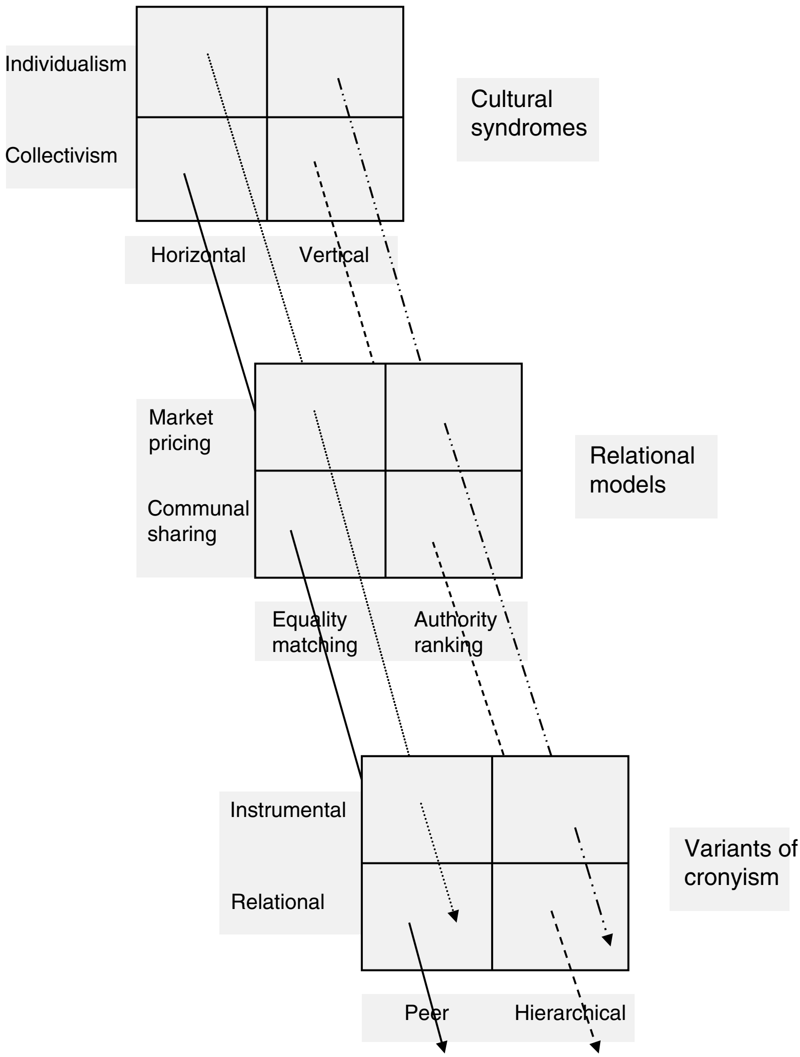

Figure 3.1 Typology of cronyism across cultures

The primary relational models used in vertical collectivist cultures are authority ranking and communal sharing. Unconditional giving, conformity, and strong in-group feelings are three central features of communal sharing: people give without expectations of what they will receive in return; conformity results from identification and the desire to belong; and inclusion is binary – either you are in or you are out. When authority ranking and communal sharing combine, people yield to the dictates of in-group leaders, show conformity and allegiance to the in-group, willingly sacrifice their own interests for in-group goals, and seek to maximize in-group success in competition with out-groups. In such cultures, the variant of cronyism most likely to emerge is hierarchical relational. As Corollary 1 indicates, this cell should see the most cronyism of any cultural configuration. Inter-group competition for status, pursuit of in-group goals, expectations for enduring relationships where members have their needs met, and focus on deference, loyalty, and obedience to superiors are likely to induce substantial levels of cronyism.

Finally, horizontal collectivist cultures have received relatively little study; thus our arguments are more speculative in nature. The primary relational models used are equality matching and communal sharing. Where these two models predominate, a strong sense of fairness among equal status members combines with intensely personal in-group exchanges that reinforce group harmony and cohesion. Consequently, in such cultures, the variant of cronyism most likely to emerge is peer relational.

Institutional safeguards

Although our explanation of cronyism relies primarily on cultural factors, we believe that culture and structure interact to create the conditions for action in a society. Institutional theory posits that sociopolitical, economic, and cultural systems develop in a particular historical context, become entrenched in societies, and then form a stable framework for subsequent interaction (Scott, 1987). Of most relevance to the present chapter, inherited legal, regulatory, and normative systems direct and constrain behavior (Biggart and Hamilton, 1992). Thus, despite inclinations toward cronyism as a natural outgrowth of humans' need for sociability and resulting desire to take care of close others, temptation does not always turn into actual cronyism because some societies attempt to minimize it through institutional safeguards (Pearce et al., 2000).

The literature on corruption emphasizes the importance of preventive measures in limiting its effects (Tanzi, 1998). A comparison between two Chinese societies, Hong Kong and Mainland China, illustrates the impact of institutional safeguards. In the late 1950s and 1960s, corruption, cronyism included, pervaded both the private and public sectors of

Hong Kong, which was not surprising given its vertical collectivist cultural orientation. Yet the Independent Commission against Corruption established in 1974 has effectively curbed corruption by extending the rule of law inherited from British governance to this domain (Au Yeung, 2000). In contrast, corruption is still rampant in China partly because of the relatively weak institutional safeguards there (Sun, 2001; Yao, 2002). However, Guthrie's (1998) study found that the use of *guanxi* in corrupt ways diminished also in China as its rational–legal system gradually improved. Therefore:

Proposition 3: Institutional safeguards mitigate the likelihood of cronyism such that it is more likely to occur in their absence.

Since the four types of cronyism have yet to be studied empirically, we lack research-based evidence about their dynamics. Nevertheless, we suggest that cultures may develop institutional safeguards to minimize some types of cronyism while neglecting others because their norms are especially blind to the latter. For example, in responding to the problem of trust among economic actors, Western legal systems, having emphasized the binding nature of contracts based on individual rights and obligations, have formulated laws to protect against relationship-based cronyist practices (Biggart and Hamilton, 1992). Britain in particular exported its executive and judicial systems and principles to its former colonial territories. As a result, states such as Singapore and Hong Kong have countered trends toward collectivist forms of cronyism rampant in other East Asian countries through strong legal prohibitions (e.g., Wong, 1996).

On the other hand, East Asian countries responded to the same problem of trust by relying on cooperative networks of personal relations to control opportunistic action. Strong normative sanctions on individuals who attempted to engage in self-serving competitive behavior helped to minimize instrumental cronyism (Biggart and Hamilton, 1992). Each form of control highlighted one form of opportunism while downplaying its opposite, with consequences for condoned behavior. For example, recent corporate excesses in the USA, such as financial analysts making purchase recommendations in tacit exchange for business from the concerned companies, seemed most often to represent instrumental forms of cronyism. Yet the cronyist cases gaining convictions in court (e.g., Martha Stewart, Richard Scrushy at HealthSouth) have often been relational. The calculative tendencies in an individualist culture may have emphasized relational cronyism as a violation while downplaying instrumental cronyism.

Using cronyism to inform research and practice

Operationalizing the concept

Cronyism begins when one party gives a favor to a second party. To constitute cronyism, the favor must satisfy four criteria: (1) there must be no immediate return of the favor or explicit agreement to return it; (2) something of value must be given; (3) the parties must share membership in a social network; and (4) it must come at a third-party's expense. Applying these criteria, researchers can readily distinguish exchanges involving cronyism from those that do not. For example, Martha Stewart was convicted of benefiting from advice provided by Samuel Waksal, a personal friend and CEO of ImClone Systems, to sell shares in his company just before it released an announcement expected to lower their value. In this situation, (1) there was no evidence of an immediate return of the favor; (2) the information had financial value; (3) the two parties were friends and Stewart served on ImClone's board of directors; and (4) Stewart's sale of ImClone's stock came at the expense of other stockholders. The Stewart–Waksal exchange clearly involved cronyism. Journalistic accounts and, in some cases, courtroom testimony richly describe the development of corporate transgressions such as Enron, WorldCom, Tyco, and HealthSouth. Researchers interested in corporate governance can test whether such factors as ethics officers, codes of ethics, and outsiders on boards of directors differentiated companies with substantial cronyism from those where it was not prevalent.

Classifying types of cronyism requires evaluation of instrumental versus relational motivations and hierarchical versus peer power relations. The latter dimension seems relatively straightforward. The former calls for judgments of intent. To classify cronyism as instrumental versus relational, the extent of focus on task versus relationship, utility versus affection, and self-interest versus loyalty must be assessed. For example, in the Martha Stewart case, evidence supports classifying power relations as peer and Waksal's motivation as based on relationship, affection, and loyalty rather than self-interest.

Transparency International's annual Corruption Perceptions Index offers an opportunity to compare cronyism across countries. The majority of Index questions taken from surveys collected by 17 different organizations (Lambsdorff, 2003) ask directly about levels of corruption. However, several refer to acts of cronyism, such as "How frequently are public contracts awarded to friends and relatives in neighboring countries?" and "How frequently are public contracts awarded to business associates, friends, and relatives rather than on a competitive bidding process?" The developer of recent rankings has acknowledged that numerous publications have asked Index compilers to distinguish among different forms of corruption (Lambsdorff, 2003). Efforts to measure cronyism would enable us to assess its presence across countries and compare it with other corrupt acts such as bribery.

Outside the public arena, researchers can use the four definitional criteria to develop vignettes that present hypothetical cases of relational, instrumental, peer, or hierarchical cronyism, as well as other acts of malfeasance. These vignettes can be used to ask whether respondents believe these situations are common in their culture, evaluate them as fair or moral, and believe participants should be penalized, as well as offer accounts of their own experiences in similar situations. Comparing responses across cultures could provide valuable information including tests of the propositions offered in this chapter. Alternatively, in a less direct approach, researchers may ask respondents about their tendencies to engage in reciprocal versus negotiated exchanges, favor friends, believe that shared network membership generates mutual obligation, and feel remorse when favors for insiders harm outsiders.

An important question is the extent to which features of cronyism generalize across cultures (etic) or are unique to specific cultures (emic). Yang's (2000) cross-cultural indigenous approach proposes a series of steps to perform tests that address the twin concerns of scientific ethnocentrism and cross-cultural equivalence. Applying this approach to cronyism, researchers from several cultures would first agree that cronyism is relevant to their cultures. Second, they would formulate a set of general principles to direct indigenous research in member cultures, specifying the purpose of the research, a working definition of cronyism, characteristics of subjects or informants, and methods of data collection and analysis. Third, they would design qualitative studies to examine manifestations of cronyism in their cultures. Fourth, they would compare the results of each study to identify aspects of cronyism that are culture-specific, culture-general, and shared within subsets of cultures. Finally, they would conduct a comparative study of cronyism based on an integrated theoretical and methodological approach with the intention to maximize the compatibility of conceptualization, research design, data collection, analysis, and interpretation while also permitting further exploration of culture-specific aspects.

Implications for research

As White notes, "To better understand corruption, much more fine-grained definitions and models must be constructed to give scholars the incisive instruments necessary to examine corrupt practices with precision. Solid theoretical foundations are needed to allow for substantive empirical research" (2001, p. 53). Grouping diverse acts of malfeasance under the general rubric of corruption limits our analytic power. The dynamics of cronyism, found in complex, indirect, and mutually reinforcing social exchanges, differ from other forms of corruption.

Although we have concentrated on two cultural dimensions, we expect additional dimensions to influence cronyism. For example, ascription–achievement may significantly affect favoritism shown by superiors to subordinates. In ascription-oriented cultures, superiors receive respect due to age and rank. In achievement-oriented cultures, they receive respect based on knowledge and performance. Loyalty and obedience are generally perceived as more important in ascription-based than achievement-oriented cultures. Thus, hierarchical relational cronyism may occur more frequently in the former than the latter.

Cultural clusters, that is, groups of countries that share many qualities (Javidan and House, 2002), may show similar dynamics related to cronyism that allow us to more parsimoniously categorize its nature and extent across the globe. For example, since bounded pursuit of self-interest is socially acceptable in the West, instrumental cronyism may not be disdained there as much as in the East. In fact, much literature in the West advocates social networking precisely to advance self-interest-related professional and personal goals. On the other hand, relational cronyism may be perceived as prototypical cronyism, an unethical behavior. Conversely, since taking care of relatives and friends is not only socially acceptable but often expected in Asian and other non-Western countries, relational cronyism may be regarded as a fact of life while instrumental cronyism is perceived as corrupt and unethical. For instance, Luo (2000) noted that some Western executives in China over-emphasize gift-giving and wining-and-dining in transparent attempts to win business. In subverting relational to instrumental purposes, they are perceived as only "meat and wine" friends. Trompenaars's (1993) example illustrates the contrast: A Westerner will say to an Asian, "You cannot be trusted because you will always help your friends"; conversely, an Asian will say to a Westerner, "You cannot be trusted because you would not even help your friends."

As a construct, cronyism has the potential to add value to several research domains. For example, researchers of business ethics who investigate the question of universal versus situational morality may find that cronyism presents a more ambiguous moral picture than other forms of corruption. When presented with examples of each, people in some cultures may label bribery and extortion wrong more often than cronyism. In another domain, our cross-cultural treatment of cronyism may enrich the leader–member exchange (LMX) theory. As a relationship-based approach to leadership, LMX depicts supervisors and subordinates as engaging in social exchanges of varying closeness and quality. Based on the conceptualization of cronyism developed in this chapter, we predict that leader–member exchanges are likely to be characterized by greater cronyism in vertical than horizontal cultures. Several studies on LMX offer preliminary support for this argument (e.g., Deluga and Perry, 1994; Durate et al., 1993; Liden and Mitchell, 1988). Further, LMX theory assumes that superiors and their subordinates exchange mutual trust, respect, and obligation across all cultures. This assumption may be an oversimplification that is consistent with leader–member exchanges in horizontal cultures, but not in vertical cultures where such exchanges are asymmetrical. For example, in vertical collectivist cultures, leader–member exchanges involve patronage and protection downward and unreserved loyalty and submission upward. In vertical individualist cultures, a superior is likely to enact an instrumental exchange largely bereft of emotion and affect with his/her subordinates.

Since the dimensions used to describe national cultures can also be applied to corporate cultures, the propositions and typology advanced in this chapter can be tested in this realm as well. For instance, disciplinary forces such as the army and police are often described as using a collectivist, paternalistic style of management that demands obedience, conformity to group norms, and respect for rank. Such a vertical collectivist culture may breed hierarchical relational cronyism. Other organizations are described as hyper-competitive, winner-take-all environments in which employees feel intense pressure to produce at any cost. For example, the trading floor at Enron was characterized as a place of such unprincipled competition that traders were afraid to leave their desks for fear that other traders would steal their work (McLean, 2001). This vertical individualist culture would seem ripe for hierarchical instrumental cronyism.

Implications for practice

Our analysis of cronyism has practical implications, especially for cross-cultural management. Expatriate managers should benefit from prior knowledge of cronyist dynamics. For example, Western managers assigned to an Asian subsidiary may be surprised to discover that their unwillingness to favor loyal subordinates over high-performing nonconformists may engender resentment, as may their own attempts to seek advancement through instrumental short-term alliances. Conversely, Asian managers working in a Western subsidiary may be unaware that building personal power bases by granting favors to subordinates in exchange for loyalty is often disliked and might be labeled discriminatory in some countries. Since cronyism arises from elemental aspects of human relations and deals with an often-sensitive part of organizational life, its inclusion in pre-departure training would help managers adjust their expectations and behaviors, as well as alert them to the possible need to design suitable preventive measures.

Knowledge of the characteristics of cronyism and its distinctness from other forms of corruption should alert managers to the multiple manifestations of malfeasance they may need to guard against. In addition, our typology indicates the types of cronyism that may be prevalent in particular cultures. For example, knowing that vertical collectivist cultures should be most prone to hierarchical relational cronyism, those monitoring subsidiaries of multinational corporations that operate in such cultures may need to enforce transparent and objective performance appraisal systems to ensure that rewards are allocated based on merit rather than loyalty. Similarly, vigilance may be needed in recruitment and selection to ensure that candidates with the best qualifications, not connections, are hired.

Since vertical individualist cultures should be most susceptible to hierarchical instrumental cronyism, governance systems may need to be especially attuned to the effects of an intensely competitive environment on individual temptations to cross legal and ethical boundaries in pursuit of self-advancement. Several recent transgressions affecting US financial markets arose from instrumental cronyist alliances. For instance, auditing divisions in accounting firms were pressured to allow questionable reporting practices so that consulting divisions could sell lucrative services to the same clients. Legislation such as Sarbanes-Oxley was designed to eradicate the defects in corporate governance regulations that permitted such transgressions. As indignation toward such cronyism fades, US law enforcement and corporate governance officials will need to be vigilant in monitoring these statutes and evaluating their effectiveness.

Conclusions

Despite its pervasiveness and powerful effects on individuals, organizations, and societies, cronyism has received scant attention from management scholars. In this chapter, we have defined cronyism using social exchange analysis, identified a typology of its forms, and proposed connections with the work of Triandis's (1995, 1996) cultural syndromes and Fiske's (1991, 1992) relational models that led to predictions of its likelihood and manifestations across cultures. We have only scratched the surface of this systemic, often subtle, complex, and dynamic phenomenon. Further understanding requires additional theorizing and empirical study.

Increased knowledge of the causes and consequences of cronyism should contribute to its effective regulation.

Note

1 *Wa* refers to the value Japanese place on group consensus and loyalty, while *inhwa* refers to harmony between unequals, such as people who are unequal in rank or power (Alston, 1989).

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Part II

Indian Brand of Crony Capitalism

4
Indian Economic Philosophy and Crony Capitalism

Naresh Khatri and *Abhoy K. Ojha*

Introduction

One grave concern that the Indian economy and society face today is that of ubiquitous corruption and cronyism. So many large scandals involving businesses and government have unfolded in the last few years (Parakh, 2014; Rai, 2014; Thakurta, 2014), and yet not many Indian scholars, until very recently, have shown any urgency to tackle this topic. In this chapter, we attempt to fill this gap by discussing the economic and political underpinnings of the problem. This chapter is organized in four sections. In the first section, the Indian variant of crony capitalism is discussed, followed by a critical review of Indian economic philosophy from 1947 to 2014 and how it bred cronyism. In the third section, we describe the current scenario and where the Indian economy might be headed. Finally, we propose new and emerging economic ideas that may be worth pursuing in the Indian context.

As Mazumdar (2008a) argued, the term "crony capitalism" is not part of the standard set of concepts discussed in economic theory. The concept became popular while trying to find explanations for the economic crisis in Asia during the late 1990s but since then has been used in a variety of ways. He suggests the word "crony" which originally simply meant friend or buddy, acquired a negative meaning similar to nepotism. Accordingly, crony capitalism emerged as a derogatory or derisive term used to describe the illegitimate use or abuse of public authority to favor businessmen or business firms who have close relations with those exercising that public authority. Comprehensive definitions of cronyism, corruption, and crony capitalism are provided by Khatri in Chapter 1 of this book.

Indian variant of crony capitalism

Johnston (2008) identified four syndromes of crony capitalism that capture important variations that can be traced to trends in the development of various societies. Specifically, the four syndromes are: (1) *influence market corruption*, which is typical of well-developed economies, such as Japan, Germany, and the USA; (2) *elite cartel corruption*, which is found in Hong Kong, Korea, and Singapore; (3) *oligarch and clan corruption*, which is reminiscent of corruption in India, Malaysia, Sri Lanka, and Thailand; and (4) *official mogul corruption*, which is commonly observed in China, the Philippines, Pakistan, Indonesia, and Myanmar (Johnston, 2008).

The syndrome that characterizes India is *oligarchic and clan corruption*. This consists of a disorderly, sometimes violent scramble among contending oligarchs and clans seeking to parlay personal resources (e.g., mass following, a business, a bureaucratic chief, judicial or organized crime connections, or a powerful family) into wealth and power. Unlike the elite cartels syndrome, in which, relatively established elites collude within a moderately strong institutional framework, oligarchs and clans contend as free agents in a climate of pervasive insecurity. Inability to enforce contracts and defend property through courts and law enforcement increases the incentive to resort to violence, making military and police services and mafia protection all the more marketable (Johnston, 2008; *The Economist*, 2012). Anti-corruption efforts in such settings are often smokescreens for continued abuse of power and to put key competitors behind bars. Privatization becomes a legalized carve-up of state resources and outright theft (Johnston, 2008; *The Economist*, 2012).

Mazumdar (2008b) argues that the roots of crony capitalism in India were established during the pre-colonial period. The grant of a royal charter to the British East India Company in 1600 providing a monopoly over trade between India and Britain may be seen as the original act of cronyism that impacted India. The company's monopoly was abolished in 1813 when the newly emerging industrial capitalist class also developed an interest in the markets in India. After 1857, the company evolved into the government in India and deepened the cronyism by favoring European, mainly British, merchants and allowing government servants who provided these favors to amass huge personal wealth in return. Crony capitalism in independent India was a continuation of the old practices with only changes in the providers and beneficiaries of government patronage. When the country adopted the idea of a mixed economy with public sector organizations occupying the commanding heights of the economy and the private sector relegated to a supportive role, the private sector became dependent on politicians and government bureaucrats to chalk out its future. This created the incentives for further entrenching cronyism that was already quite well established since before independence. As will be discussed later, the cronyism that took root during the period the country followed a socialist philosophy has been labeled crony socialism, and the version that has been entrenched since 1991 when the country adopted a more capitalist philosophy has been labeled crony capitalism.

The socialist model championed by various central governments since India's independence made the survival of Indian businesses very much dependent on government (Shourie, 2009). Most of the decisions were centralized in Delhi. A result was the evolution of a unique Indian business model in which cultivating political connections in Delhi became the core competence and the most important survival imperative for businesses (Das, 2001; Dhume, 2011; Gandhi and Walton, 2012). Relationships of businessmen with politicians served as a "master key" enabling them gain access to all sorts of resources (Bajaj and Yardley, 2012). The core of this model is largely intact even today. Narayanaswamy (2013) provides an accurate explanation of the reasons why political connections are critical for doing business in India. First, the government controls access to finance because of its ownership of major banks and appoints the chief executives and other senior managers of the banks. Second, government-owned entities operate in a number of important industries such as steel, manufacturing, energy, transportation, telecommunication, and mining. Third, the government controls ownership and access rights to resources such as land, minerals, oil, and gas. Finally, the government, or the regulatory bodies controlled by it, has vast administrative powers involving a high degree of discretion. These include approving mergers and acquisitions, issuing licenses for airlines and distilleries, approving cross-border collaborations and foreign investments, deciding on tax matters, giving environment permissions, and permitting raising of capital overseas.

The former Comptroller and Auditor General of India, Vinod Rai, has described how such government control led to major dysfunctions in the Indian economy (Rai, 2014). Rai observes that handing out contracts and rigging of bids for the undeserving have done untold harm to the Indian economy. Agencies with inadequate domain knowledge cornered contracts and finite natural resources. Cronies muscled their way into major infrastructure projects thereby denying the meritorious their legitimate dues. Such deals were possible because of the opacity in government procedures (Rai, 2014). According to Rai, the worst part of the process was that the cronies were advised to bid at rates that ensured their bids were winners. Once the bids were accepted, the saga of concessions started and many of these cronies did not complete the projects despite colossal cost overruns and delays (Rai, 2014). Similarly, Parakh (2014) describes in significant detail how different central government ministers and their cronies conspired to allocate natural resources to undeserving organizations causing considerable damage to the country's economy. Thakurta (2014) suggests that the cronyism was so entrenched that certain powerful business houses, Reliance Industries in particular, could have the ministers changed if they did not agree to policies or policy changes that favored them, even if it came at the cost of the country and economy. Baru (2014) indicates that much of the cronyism was beyond the control of the then prime minister, Manmohan Singh, as the real levels were with the president of the INC (Indian National Congress, also known as the Congress party), Sonia Gandhi.

Jagannathan (2014) argues that the Indian brand of crony capitalism has four pillars. The first pillar is *the business group*. Unlike the west, where conglomerates are dying, Indian corporations have been built around business groups and are prospering as a result. Most of India's billionaires are well-connected oligarchs who have exploited stealth privatizations and huge and inefficient government subsidy programs to amass fortunes. The second pillar is that Indian businesses have had *very little skin in the game*. Indian corporate businesses have had a cavalier attitude toward loan repayment because they have very little of their own capital at stake in almost any business. By using fraudulent accounting practices and tax loopholes, most promoters recover their investments in the early years of a project and then rely on public funding through public sector banks to finance their activities. In other words, thanks to political connections and plain corruption, most Indian capitalists have built empires out of thin air. The third pillar is the *public rescue for private losses*. The fact that nationalized banks funded most of Indian private businesses in the past ensured that many businesses got away scot-free even when they failed to pay up and landed banks in a mess. In the 1960s and 1970s, entire industries in textiles and jute went sick and were taken over by public sector corporations which racked up losses paid for by tax payers. Banks which funded the losses were also recapitalized by the government in order to keep up the "good work." The fourth pillar is *weak and discretionary regulation*. Formal laws covering corrupt activities have existed but the enforcement has been absent or weak. Institutions of accountability have also existed but they have been ineffective. Indian civil servants have also resorted to discretion and official secrecy (Jagannathan, 2014; Gupta, Chapter 9 in this book).

The crony capitalism that we see in India today is a *brazen* variety (*Global Citizen*, 2012), and it is the underlying force behind the establishment of the corrupt pseudo-aristocracy that has been taking shape in the country for several decades, a synthetic privileged class made up in large part of politicians, businessmen, bureaucrats, criminals, mafia, and hangers-on who have become expert in exploiting the rest of society (Snow, 2011). Crony capitalism has become deeply entrenched in Indian government, culture, and society and has elevated unproductive activity to a higher cultural status than productive activity (Gupta, 2013b; Mitchell, 2012; Singh, 2013a). A good barometer of how progressive or regressive a society is to look at where an individual's merit ranks in the list of selection and promotion criteria. While highly intelligent, hard-working people hold menial jobs, mediocre and unethical people often hold distinguished positions (Zingales, 2012). Rand's (1992[1957]) quote applies so aptly to the current state of the Indian economy and society: "When you know that in order to produce, you need to obtain permission from men who produce nothing, when you see that money is flowing to those who deal not in goods but in favors, when you see that men get rich more easily by graft rather than by work, and your laws no longer protect you against them but protect them against you, you know that your society is doomed."

A critical review of the transitions in Indian economic philosophy (1947 to 2014) and resulting cronyism

Mukherji (2010) has suggested that Indian economic philosophy after the country's independence can be understood in four different periods. The first period is the period between 1947 and 1968, which he describes as the compromise between state and private enterprise. The second is the period between 1969 and 1974, which represents the rise of state capitalism. The third, between 1975 and 1990, was the slow evolutionary process of reforms. The fourth period, after 1991 to the present, represents the phase of radical reform relative to the past but still gradual (Ahluwalia, 2007) in relation to reforms in some other economies. In order to understand the transitions in economic philosophy in India one also needs to understand the underlying political processes that shaped the debates that led to the adoption of various policies (Mukherji, 2010; Varshney, 2010).

Period 1: 1947–1968

At the time of independence in 1947, cronyism was well entrenched in the Indian economy. As mentioned earlier, the first act of cronyism that affected India was the exclusive trading rights to the East India Company (Mazumdar, 2008b). This changed to favor British companies and other multinationals during the colonial period. Toward the end of the colonial period, a third set of people, owners of a few Indian firms that had set up business to facilitate raw material for British companies or chose to distribute their products, were also part of the crony network.

The initial economic philosophy adopted after independence has to be understood in the light that many leaders of the Congress party which came to power after independence were sympathetic to socialist ideals. This included the first prime minister of India, Jawaharlal Nehru. Many of them were impressed with the progress in the then Soviet Union and argued in favor of the radical redistribution of wealth and abolition of private property, an economic view termed as "Nehruvian socialism" (Bhagwati and Panagariya, 2013). However, many others, including the first home minister of India, Sardar Vallabhbhai Patel, along with several state leaders and business elite opposed any such radical moves and supported more market- oriented economic policies (Bhagwati and Panagariya, 2012). Similar views were supported by the Swatantra Party and later the Jan Sangh, which became the Bharatiya Janata Party (BJP). Hence, the policies that were implemented in this period were a compromise between the two opposing views (Mukherji, 2010).

Despite the report of the Economic Programme Committee of the Congress party in 1948 recommending large-scale nationalization, public ownership of monopolies, and an end to the system of management agencies, the Industrial Policy Resolution adopted in the same year suggested exclusive government ownership in only three sectors, and the right for government to enter six other sectors, with the remaining economy left to the private sector. Also, the Company Law of 1956 allowed for the continuation of management agencies as a form of business. Reflecting similar compromises, the Industrial Development and Control Bill of 1949 was changed to the Industrial Development and Regulation Act of 1951 which provided for less government interventions in the economy than envisaged earlier, and the Planning Commission became more of an advisory body than an implementation organization. However, after the death of Patel and other changes within the Congress party, over time the policies gradually tilted in favor of the state and away from a reliance on markets and the private sector. The Industrial Policy Resolution of 1956 emphasized large-scale industries in the public sector, and the economy became essentially driven by the government with significantly less scope for the private sector. Ironically, this emphasis on large-scale industry also resulted in a decreased focus on agriculture. At the end of Nehru's prime ministership, the overall economy was in bad shape. Further, the war with China had not helped matters. The next prime minister, Lal Bahadur Shastri, did try to make some efforts to revive the agricultural sector and reduce emphasis on capital-intensive industrialization in the public sector, but the war with Pakistan and his untimely death did not help matters.

Explaining the economic philosophy choices made by the government of independent India during the early days, Jalan (2004) argues that like political independence, economic independence was something that the Indian nationalist movement had learnt to value. Hence, rather than trade with the former colonizers and their affiliates, the government adopted aggressive import substitution and reduction in India's dependence on foreign trade and foreign investment. The reliance on the public sector to pursue these objectives was influenced by the perceived success of the Soviet bloc. The belief that public ownership of the means of production will contribute to societal welfare was well accepted. Another reason for the reliance on the public sector was that once the focus on heavy industry was finalized, there was a realization that the private sector in India did not have the capital or the technology to make the investments so if dependence on multinational corporations (MNCs) had to be reduced, there was no other option but to adopt a public sector-led growth plan.

Thakur (1993) argues that in the early years after independence, government policies reflected choices based on three sets of dichotomies. It chose central planning over market anarchy, public ownership over private ownership of the means of production, and egalitarianism over class-based income distribution. However, in the implementation they focused on investment targets rather than efficiencies. He suggests that while it is quite okay to criticize the choices in hindsight, the economy actually did quite well in the period. The economy grew three times faster in the first two decades after independence than it did in the decades before independence. During this period domestic savings improved, dependence on food imports reduced, and foreign exchange reserves also improved. Further, there were improvements in social health indicators such as infant mortality, life expectancy, and adult literacy.

However, the downside of the economic philosophy was the gradual centralization of economic decisions and the role of government in matters of economics. As Mazumdar (2008b, 2011) suggests, cronyism in its new form took root immediately after independence. Some business houses had been very closely involved with the freedom struggle and had access to the Congress party leadership and the government, while others developed those linkages to cope with the dependence on the visible hand of the government in matters of business. Gradually, it was well established that a key capability that business houses needed to develop was an expertise in managing the government, including the political leadership and the bureaucracy.

Period 2: 1969–1974

A significant change in economic philosophy of the country or a change in gear further entrenching the role of state occurred in 1969 which led to the rise of state capitalism (Mukherji, 2010). Indira Gandhi succeeded Shastri as the prime minister in 1966. However, there was internal rift within the party. In order to consolidate her hold over the party, and also seek the assistance of the left parties, Gandhi enhanced the role of the state in an unprecedented way. The Monopolies and Restrictive Trade Practices (MRTP) Act of 1969 imposed restrictions on enterprises larger than Rs. 200 million. In the same year, major banks were nationalized followed by nationalization of the coal industry, copper industry, segments of the steel industry, and also the general insurance industry in 1971; and the wheat trade in 1973. A stringent industrial license policy was implemented in 1970 and the Foreign Exchange Regulation Act restricting foreign ownership in firms was adopted in 1974.

Mazumdar (2008b) suggests that several private sector companies were negatively affected by the changes. However, cronyism did not cease but actually increased. In fact, a few large business houses had actually succeeded in maintaining a steady dominance over the industrial sector in the first decade and a half of planning and were able to further establish the monopolistic advantages despite the apparent increase in the role of the state to decrease the power of private capital. Mazumdar's (2011) analysis suggests that thanks to cronyism many large firms were able to, or allowed to, circumvent the requirements of the new provisions and continue their dominance in their markets.

However, due the prevalence of the "license and inspection raj" the overall economy and industrial production stagnated during this period (Das, 2011). Thakur (1993) explains how the policies to help small industries actually impeded their growth. The implications of success and growth were so negative that many small industries did not expand. Unfortunately, when they became unviable because of the poor policies, they were not allowed to close down only exaggerating the challenges of conducting business in the country. However, as a collective these policies not only created highly inefficient public sector monopolies but also, due to cronyism, protected private sector monopolies.

Thakur (1993) uses the notion of proscriptive versus prescriptive economic regimes as suggested by Jagdish Bhagwati to explain the roots of cronyism in India. Under prescriptive regimes, prevalent in East Asian economies, the government intervenes to provide direction to the economy but leaves the actual business decisions to the economic actors in the market. While such systems may be affected by cronyism in the policy formulation stage, once the policies are in place normal market forces prevail. However, during this period India adopted a proscriptive regime. This created a "negative administrative culture" which is not only subject to cronyism in the policy formulation stage but also in the policy implementation stage. During the implementation of these policies, government officials have the power and discretion to refuse permission for most private initiatives. This creates ample opportunities for cronyism as the ability to manage government officials and politicians can provide quasi-monopoly rents for those few who do manage to get licenses or import quotas or other discretionary decisions in their favor (see Gupta, Chapter 9 in this book). The long-term consequences of these economic policies resulted in the corruption of public morals. Summing up his arguments, Thakur writes:

> India is notorious for its influence-peddling politicians, money-seeking bureaucrats and bribe-dispensing entrepreneurs. A permit license raj creates recurring shortages and multiplies opportunities for illicit profit or 'rent'. Because action depends on bureaucratic and political discretion, the discretionary application of controls makes the rent part-property of the minister and the civil servant making the decision. Bribery is so thoroughly institutionalized in India that most people engaged in the transactions are aware of the scale of the charges and the lateral and upwards percentage shares in the illicit rent. (Thakur, 1993: 145–146)

Period 3: 1975–1990

While the changes in economic policy in the earlier period helped the truncated Congress and Indira Gandhi consolidate popular support, the failure of the economy to deliver gains was evident by end of the period. By the mid-1970s, the limitations of state capitalism based on import substitution, public sector dominance, and extensive government control over private sector activity had become evident. This also led to political unrest in the country and the proclamation of a state of emergency in 1975 during which significant political rights were curtailed.

However, it also coincided with the earliest attempts by the Congress government to liberalize the economy. The small changes in economic policy to gradually encourage trade and industry however were overshadowed by the political upheavals during that time. In 1981, the country had to take an International Monetary Fund (IMF) loan to deal with the impact of oil prices. This led to an impetus to liberalize the economy. The Janata Government which was a coalition which included the Jan Sangh (which became the BJP) was in power during 1977–1979, also made some moves toward liberalization. They promoted small-scale industry, eliminated price preferences for public sector firms, abolished price controls on sugar and certain food items and eased some of the restrictions on the private sector. With the return of Indira Gandhi, after the premature fall of the Janata government, the gradual shift continued. The Rajiv Gandhi government attempted to provide an impetus to reform by changing the norms of the MRTP Act and providing greater autonomy to public sector organizations. However, internal opposition and allegations of corruption against the prime minister saw a gradual retreat from the liberalization agenda leading Varshney (2010) to refer to it as the period of stalled reforms and others to label this phase the period of creeping economic reforms. The creeping liberalization has some limited success with GDP growth accelerating from 3.5 percent to 5.6 percent, and the poverty head count ratio falling for the first time since independence (Varshney, 2010).

However, the old business houses that had learnt to deal with the restrictions continued to prosper (see Varma, Hu, and Bloomquist, Chapter 8 in this book). The ability to manage government officials had a big impact on the performance of business houses. Mazumdar (2008b) suggests that cronyism was involved in systematically allowing deviations from the government's formal policies. Sometimes, private corporations with connections willfully violated the policies of the day with the comfort that the deviation could be approved *ex post*. While most of the beneficiaries were old business houses, Mukherji (2010) suggests that Reliance Industries was probably the only industrial house that emerged during this period and its growth was based on maintaining excellent relations with the state. This trend was continued by other governments that followed although they had shorter tenures based on coalition support.

Period 4: 1991–2015

Creeping economic liberalization gained momentum only in the 1990s. The turning point in the Indian economy came on July 24, 1991, when a Union Budget that changed the course of the country's history was presented. Ahluwalia (2007) suggests that since that budget there was a significant shift in economic philosophy, under the Congress-led government headed by P. V. Narasimha Rao as prime minister and Manmohan Singh as finance minister. The changes

> signaled a systematic shift to a more open economy with greater reliance upon market forces, a larger role for the private sector including foreign investment, and a restructuring of the role of government. (p. 87)

There was a significant shift in industrial policy with the reduction in industries reserved for the public sector going down from 18 to three: defense production sector, atomic energy generation and railway transport. Industrial licensing, except for some sensitive industries, was eliminated. The MRTP act was abolished and there was a gradual reduction in items reserved for the small-scale sector. Export and import regulations were simplified and tariffs were rationalized to encourage globalized trade. Foreign direct investment was liberalized with 100 percent ownership in certain industries. This trend of liberalization has been entrenched further over time by successive governments. These initiatives have been accompanied by financial sector reforms and divestment of government holdings in the public sector. Emphasizing the role of political economy on economic policy, Varshney (2010) suggests that the minority government of Narasimha Rao was able to do more than the majority government of Rajiv Gandhi not just because of the foreign exchange crisis but also because the Left parties were willing to cooperate to keep the BJP out of power.

While some have suggested that liberalization was just a pragmatic way to meet the compulsions of a near-bankrupt economy without any real change of heart, most commentators believe that 1991 and 1994 were significant turning points in the economic philosophy of the country. Different governments have been in office since 1991, the Congress-led government till 1996, the United Front coalition from 1996 to 1998, the BJP-led coalition which was in power in 1998, and again the BJP-led NDA (National Democratic Alliance) from 1999 to 2004. With variations in emphasis, they have been able to sustain the process of reform.

The Congress-led United Progressive Alliance (UPA), from 2004 to 2009 and especially from 2009 to 2014, showed a shift back to the old socialist model championed by Indira Gandhi, undoing the growth momentum and many gains that had started attracting attention of the rest of the world (Gupta, 2013b; Khatri, 2011; Luce, 2008; Singh 2013b; 2013c).

As argued by Jalan (2004) the process of liberalization and economic reforms launched in 1999 has yielded positive results after it removed some of the structural rigidities and created potential for higher growth. However, he cautions that there is a need to

> further improve our economic decision-making processes, remove scope for political discretion, reduce unproductive expenditure, and improve the quality of governance at all levels. The system must be made to work in the interests of the public in general, rather than the few, including those who are supposed to serve the public, namely, government servants and elected representatives. (Jalan, 2004: 3)

Having served as the governor of the Reserve Bank of India, he was acutely aware of the potential of cronyism to derail the gains of the liberalization process. Similarly, Mazumdar (2008b) suggests that

> the idea that liberalization signals the beginning of the end of crony capitalism is based on a misconception that with liberalization the State ceases to be an important factor in the economic arena. Liberalization involves a process of transition whose key agent is the State, and creates in its wake numerous opportunities of conferring benefits on businesses having a privileged relationship with decision-makers. Just as regulation can provide the smokescreen for crony capitalism, liberalization can similarly provide a smokescreen for granting favors to cronies. (Mazumdar, 2008b: 13)

He suggested that all segments of the economy have been significantly affected by decisions of the central government and outside the information technology industry, most business houses, old or new, have benefited from their proximity to the political leadership of the government in power. He argues that while many expected the liberalization process to put an end to cronyism, it has only increased with renewed vigor (Mazumdar, 2008b).

As can be seen from the above discussions, the brazen form of cronyism that exists in India today is no accident. There are underlying forces that propel it. One of these driving forces has been Indian economic philosophy.

An interesting question that puzzles scholars is whether corruption and cronyism can coexist with rapid economic growth. There are several examples that suggest that it is possible to grow rapidly despite pervasive corruption and cronyism in the system, although it depends on whether a system is following a liberal economic strategy or a statist-nationalist strategy (Lankester, 2004). Several studies (e.g. Ho and Huang, 2011) suggest that while there may be a short-term positive impact of cronyism on economic growth, the long-term impact is either not sustainable or actually negative. Kato and Sato (2014) estimate that the impact of cronyism on the manufacturing sector in India was significantly negative. A liberal economic strategy is one where the state relies primarily, but not exclusively, on markets and on the private sector to generate growth; where exports and inward investment are encouraged; where the state intervenes selectively to correct market failures but sees its main role as providing public goods such as health, education, training and infrastructure, and a supportive macroeconomic policy. A statist-nationalist strategy is one where the state plays a much more interventionist role in allocating resources and organizing production; relies on markets and the private sectors to a far lesser extent; stresses import substitution and self-reliance rather than export growth; and discourages inward investment. The form of corruption in a liberal economic strategy is likely to be what is termed *crony capitalism* and corruption in a statist-nationalist strategy is likely to take the shape of *crony socialism* (Dhume, 2011; Singh, 2013a, 2013b, 2013c).

Lankester (2004) argues that while both forms of cronyism, whether socialist or capitalist, are problematic, crony capitalism is less so than crony socialism. He states that, in a period of 30 years, from 1960 to 1990, Indonesia pursued a liberal economic strategy whereas India mostly followed a statist-nationalist strategy. It was this difference in strategy that led to Indonesia's spectacular economic success over those three decades and India's dismal economic performance over the same period.

Similarly, Bai et al. (2014) argue that the rapid economic growth in China in the last 30 years can be greatly attributed to the Chinese brand of crony capitalism. The communist party abstained from crony capitalism in the first three decades after it took power in 1949. The nationwide campaigns against capitalism and corruption launched in the early 1950s exhibited the party's zero tolerance for rent-seeking. The focus of the party shifted away from this political agenda since the late 1970s. The change was primarily driven by the desire of grassroots party cadres to make their people and themselves rich. Since the change in philosophy, the communist party has shown astonishing tolerance of the private benefits that party cadres obtain from their interactions with the business sector. These benefits range from legal income as bonus to illegal income as bribes, from private consumption funded by firms to explicit equity stakes in private business held by family members. Party members that show better performance in economic development are promoted in the hierarchical political system. Political leaders are fully incentivized to support their cronies for economic development which is one of the chief features of crony capitalism with Chinese characteristics (Bai et al., 2014).

Since India's independence in 1947, India had one of the most controlled economies in the world outside the Communist bloc. There were administrative controls on prices, on industrial investment, on bank lending, capital markets, on imports and even on some exports. The state reserved for itself the ownership of many key industries; other industries were reserved for small-scale enterprises; domestic industry was heavily protected; competing imports were mostly banned; and inward investments were discriminated against. Large private businesses were prevented from expanding. The public sector provided plenty of jobs but placed a heavy burden on the rest of the economy. This phase of Indian economy is known as "Hindu rate of growth." We term it as the "lost time" or "lost generation." We belong to this generation that had to bear the brunt of the adverse consequences of a dysfunctional economic philosophy. During this time period, India rather than catching up with other developed economies/nations lagged further and further behind. Many economies/nations such as Malaysia and Singapore that once looked up to India have since sprinted past India in their economic performances.

There are other striking examples of economies that suggest that the same magnitude of corruption but of a different variety has a significantly different impact on a country's economic growth. For example, both South Korea and the Philippines suffer from corruption (Kang, 2002). Whereas, South Korea grew at a tremendous pace, the Philippines did not. This may be attributed both to the type of economic system as well as the type of corruption. South Korea has followed a liberal economic strategy (crony capitalism) and it has had an elite cartel corruption which is less harmful to the economic growth than the combination of statist-national economic strategy (crony socialism) and the official mogul corruption prevalent in the Philippines (Kang, 2002).

Narsimha Rao's Congress-led government at the height of economic and political crisis in early 1990s began unshackling the Indian economy which was further liberalized during Atal Bihari Vajpayee's BJP government. The Indian economy showed vibrancy and became the talking point around the world. But then, as often in the past, the Indian people self-inflicted a tragedy of sorts by not rewarding the government by voting it to power again but instead provided a fragmented vote. This allowed the Congress to return to power at the core of a new alliance government, the UPA (Gupta, 2013a). Like during the period of 1969–1975, the government had to lean on support from the Left parties which again coerced the government to withdraw from the liberalization agenda. Some interpreted the mandate to mean that the Indian masses wanted to send a signal to the politicians that economic development was not the issue that they cared about; they only cared to be pandered, appeased, and emotionally blackmailed based on caste, ethnicity, religion, and region (Sharma and Kashyap, 2013). Unsurprisingly, the UPA alliance went back to the brand of crony socialism that had prevailed in the earlier Congress governments (Luce, 2008; Singh, 2013a, 2013c). However, it was not the Left parties that indulged in cronyism but other opportunistic coalition partners that exploited the precariousness of a coalition government.

From 2004 to 2014, the two Congress-led governments shared this philosophy and promulgated huge social programs like National Rural Employment Guarantee Act (NREGA) and the Food Security Bill, which found an advocate in Amartya Sen, a Nobel Laureate for 1998 in Economics. This economic philosophy of *garibi hatao* (remove poverty) with ill-conceived social programs bogged down the Indian economy and scared away multinational corporations and foreign investors (Gupta, 2013b; *The Asian Age*, 2012; *The Daily Star*, 2011). India rather than moving forward with liberalization began returning to some of the very practices that prevailed before 1991. Gupta (2013b) claims that UPA's "welfarism" betrayed the promise of economic reforms and created a doctrine of "povertarianism" which condemns Indians to perpetual poverty.

We draw two conclusions from India's economic performance since 1947. The first conclusion is that India probably could have done significantly better economically than it did from 1947 to 2014. Indian politicians and intellectuals of the time stuck to their economic vision for too long (Gupta, 2013a, 2013d; Luce, 2008). They entrenched and perpetuated crony socialism, the worst of all economic models, by giving unfettered power to the central government in the economic affairs of the country (Dhume, 2011; Singh, 2013c; *The Economist*, 2012). Cronyism thrived because the political culture in the country, particularly in the Congress party, the party that has ruled the country most of the time since independence. (Gupta, 2013b; Mehta, 2013; Singh, 2013a, 2013b, 2013c; Trehan, 2013).

The second conclusion is that despite the side effects of crony capitalism such as increased income inequality, crony capitalism provides more economic dynamism and growth and is thus better than crony socialism (Dhume, 2011). Crony socialism focuses on dividing available value among cronies without providing incentives to new value creation, while crony capitalism, equally bankrupt in terms of morality, at least provides incentives to create value that is beneficial to society. However, as discussed later, crony capitalism has its own major drawbacks. There is a need to ensure that crony capitalism is managed better to ensure the positives outweigh the negatives while it persists and ultimately to eliminate cronyism altogether.

The current scenario and where the Indian economy might be headed next

We got an early glimpse of how the economic philosophy of the BJP (the party in power with its allies known as the NDA) might differ from that of the preceding government during the 2014 Lok Sabha elections. The Congress Party, the Left parties and other parties in the opposition relied significantly on the perspective offered by Amartya Sen (Sifyfinance, 2015). On the other hand, the BJP and its allies relied largely on the perspective offered by Jagdish Bhagwati to support their economic philosophy (Sifyfinance, 2015; Singh, 2013b). Bhagwati argues that only a focus on growth can yield enough resources for investing in social sector schemes. According to him, growth may raise inequality initially but sustained growth will eventually raise enough resources for the state to redistribute and mitigate the effects of the initial inequality.

The debate between the two perspectives has been enlivened after the release of new books by the two sets of researchers. In, *Why Growth Matters: How Economic Growth in India Reduced Poverty and the Lessons for Other Developing Countries*, Bhagwati and Panagariya (2013) argue that rapid economic growth is the solution to India's problems. The book came out just before *An Uncertain Glory: India and its Contradictions*, where Sen and Drèze prescribe state-led redistributive efforts as the solution to India's problems.

In our view, the NDA government headed by Prime Minister Modi is leaning toward a liberal economic philosophy. While the UPA government before it depended on Sen's worldview for economic ideas and policies, the new government appears to be solidly adopting Bhagwati's views as is evident from the fact that Bhagwati's close colleague, Professor Panagariya, has been appointed as the vice-chairman of the Niti Ayog, India's policy-making body (Sifyfinance, 2015; Singh 2013b). This is unlike the former prime minister, Manmohan Singh, who was handpicked for the position by the president of the Congress Party and did not have much discretion and decision-making power (Baru, 2014; Gupta, 2013a), Prime Minister Modi has a mass following and wields significantly unfettered power in his own party. He can pursue his own ideas forcefully. It would seem that Modi's philosophy will play a major role in how India progresses in the next few years. He seems to abhor red tape and regulation. He wants to open up things and grow rapidly. His approach to governing India thus far seems similar to a chief executive running a company. He has shown tremendous amount of energy. In a short time, it appears that he has spread a nice vibe in Indian masses and promulgated goodwill about India internationally. He has radiated confidence and created a sense that things are under control. He is also catching lucky breaks in that global stock markets are doing well that help not only the Indian stock market but Indian economy as well. Oil prices have been falling which is a big bonanza for a country like India where oil import is a big drain on the treasury.

Aligica and Tarko (2014) argue persuasively that there is always a danger of populism especially in a society like India which is very diverse and thus it is easy to exploit racial, religious, and regional faultlines, education is low, civic values are not all that developed, and the notion of public over private interest is foreign. The idea of populism refers to the appeal to the current state of popular opinion. The Congress party used socialist policies, caste-based reservations, and attention to religion-based groups derisively referred to as "pseudo secularism" to appeal to the Indian voters (Gupta, 2013c; 2013d; Singh, 2013b; 2013c; Trehan, 2013). This populist rhetoric worked effectively for a long time as the Congress party remained in power for over 60 years. Unfortunately, populist policies unavoidably end up in failure over the long term due to their inherent macroeconomic unsoundness and unsustainability. This is what exactly happened with the populism advocated by the Congress party (Gupta, 2013d; Singh, 2013a, 2013b).

We believe that a danger of populism lurks in Modi's case as well. He is charismatic and articulate. He can legitimize crony capitalism as "pragmatism" and "middle-of-the-road" moderation and ignore sound economic policies which he and his party may not fully understand. Indian people may realize only some years down the road that Modi and the NDA took them for a ride. This has happened to Indians many times in the past. The danger is real as, from our perspective, misplaced, untimely and irrelevant policies and practices are being followed by the hard core ideologues of BJP. They may undermine the more liberal, enlightened, and uplifting approach of Modi. He will have to keep many of his detractors from his party at bay (Bhagwati, 2015).

We think that BJP is inherently a pro-business party. It has many vested business interests that are bound to lead to crony capitalism. When it was in power last time, it liberalized the Indian economy and boosted business dynamism. Unfortunately, the economy grew in a lopsided manner as usually happens if the economic model is akin to crony capitalism. The fruit of economic dynamism failed to reach the Indian masses. Elites fared well which gave the government an unfounded overconfidence to win elections the second time. But we all know too well what happened. BJP may be wise not to repeat it for its own sake. It will have to make sure that interests of all sections of the society are represented which is a formidable challenge for any society let alone the Indian society.

Like the government before it, the current government depends on interest groups to fund its election and political campaigns (see Gowda and Sharalaya, Chapter 7 in this book). These are the inherent compulsions that create a challenge for any political party. Can Modi and BJP rise to the occasion and curb crony capitalism to manageable levels so that its side effects are not serious?

Regarding strategies to combat corruption, we have learnt a couple of lessons. The first is that a narrow economics approach emphasizing incentive and accountability-based remedies has not been effective in curbing corruption significantly (Laver, 2014). The track record of international development agencies that used such approaches is lackluster, particularly in relation to reducing systematic corruption (Laver, 2014). Why have two decades of anti-corruption strategies failed to measurably reduce systematic corruption? While many explanations have been offered, Laver (2014) suggests that one of the most important reasons lies in not adequately dealing with the political and cultural drivers of systematic corruption. Systematic corruption reflects a conflict or misalignment between formal rules and norms and their underlying value systems (see Billing and Farro, Chapter 6 in this book). Thus, a more multidisciplinary, holistic, and pragmatic view of cronyism as presented in this book might be needed to curtail corrupt behavior.

The second lesson is based on the Chinese experience. Zheng (2015) finds that although unrestrained corruption is always bad and leads to overinvestment, under certain conditions, society may benefit from a moderate level of corruption in the short run. Zheng's second finding is that a drastic or heightened anti-corruption drive affects the economy adversely by reducing both the levels of effort and investment. His third finding is that anti-corruption policy affects competent bureaucrats more than less competent ones. Thus to retain more competent bureaucrats in public service, salaries may have to go up at the same time as anti-corruption effort increases. For example, the Singaporean government compensates civil servants on par with private sector salaries to attract and retain bright individuals (see Gupta, Chapter 9 in this book). Finally, incentives to develop infrastructure projects are greater if bureaucrats in charge of implementation can benefit from the development personally. Thus, there should be in-built incentives for bureaucrats who are in charge of the projects.

Crony capitalism and Indian economy: new directions

How do nations move from a state of affairs where corruption is the norm to one where corruption is the exception? The ideas proposed by Mungiu-Pippidi (2013), Resico (2013), and English (2013) begin to answer this important and complex question. Mungui-Pippidi notes that, thus far, Europeans have enjoyed the most success in containing corruption, alongside a group of former colonies populated mostly by Europeans and a handful of other countries. Consequently, most states around the world, both new and old, have come to subscribe presently to a norm based on the classical European intellectual heritage: the doctrine of ethical universalism in public life (Mungiu-Pippidi, 2013). This doctrine has three features: (1) participation in public affairs, (2) public office not as privilege but civic duty, and (3) everyone is equal before the law. By and large a governance design based on civic duty, participation, cooperation and direct and indirect elections promote the norm of ethical universalism.

We acknowledge that what qualifies as cronyism differs around the world partly because of different institutionalized norms and partly because cultural systems support different ways (as discussed in the next two chapters). As Hooker (2009) argues:

> activities such as nepotism or cronyism that are corrupting in the rule-based cultures of the West may be functional in relationship-based cultures. Behavior that is normal in the West, such as bringing lawsuits or adhering strictly to a contract, may be corrupting elsewhere. Practices such as bribery that are often corrupting across cultures are nonetheless corrupting for very different reasons. (Hooker, 2009: 251)

Hooker (2009) suggests that while India may have imported some Western institutions, it is essentially a relationship-based culture that still relies significantly on family and social relationships. Hence, even though the government operates nominally on a parliamentary system but real power is often exercised through a web of social relationships that are sustained even when governments and political ideologies change. Khanna and Johnston (2007) suggest that given the complexities in the workings of government systems in India, some form of cronyism is inevitable and even beneficial. However, we believe that India should adopt a path that in the long run eliminates the incentives for cronyism to exist.

Resico (2013) compares three economic models: the current capitalist model as pursued in the US and other western countries, state capitalism and the social market economy. He argues that the current global recession resulting from economic concentration, occupation of regulating agencies by interest groups and unwise de-regulation, calls into question the soundness of de-regulated market capitalism as practiced in US and other developed economies. A social situation in the developed world has arisen with a weakening of civic and democratic values in a number of countries revealing the flaw in the model. The other common economic model is state capitalism. Resico (2013) defines state capitalism as a system whereby the government holds the role of dominant economic player and employs markets basically for its political benefit. State capitalism relies on three key players: state-owned companies, allied private domestic corporations and public financial funds. This has been the dominant economic model in China since early 1970s and there are elements of it in Indian economic scenario as well. State capitalism has many limitations that increase with time. Economic decisions made by politicians and bureaucrats add inefficiencies and make the economy less competitive, efficient, and productive. Greater administration expenditures, inefficiency and increasing public corruption add costs to market activities (Resico, 2013).

According to Resico (2013), there is a third and a better alternative between deregulated market capitalism and state capitalism: the social market economy. The social market economy marries free market economy principles with social policy arrays and is to be found in Scandinavian countries. It emphasizes individual initiative, productivity, efficiency and self-regulation, along with basic contributions found in social traditions of solidarity and cooperation based on fairness and justice in a given society. In other words, the free market principles of individual rights, republicanism and the market are combined with social policy principles of human dignity, social justice, and solidarity. It seems that social market economy is the appropriate model for India to emulate (see Ojha, Chapter 5 in this book), although the conditions that prevail in India at present may not be fully ripe for implementing such a model.

English (2013) argues that a number of unique conditions enabled modern, developed democratic states to be economically productive and socially cohesive – conditions that are not inevitable and which must be cultivated outside the logic of democratic bargaining. He points out that "liberal ethics" is one such condition that is paramount and warrants attention from these democratic states if they want to stay on the path of economic success. The term "liberal" indicates a respect for the liberty, autonomy, and equality of others, along with rights of person, property, and fair treatment. English stresses that democracy has inherent corrupting tendencies of rent-seeking, grandstanding, unsustainable borrowing and that "liberal ethics" ingrained in the citizenry is the antidote along with a free press.

According to English (2013), the separation of the domains of economics and politics is of foremost importance in the prosperity of the Western liberal democracies. Further, each of these domains is governed by the logic of competition that produces public benefits. In economics, firms compete for customers on the basis of price and quality rather than seeking monopolies or rents from the government. In politics, candidates compete for votes by appealing to the interests of citizens and promises of better government rather than via force, censorship or oppression. Crucial to both of these domains is an overarching ideal of government by law in which rules that promote justice and fair competition are publicly promulgated and applied impartially to all. Based on English's arguments, a recommended economic recipe for India will include inculcating liberal ethos in Indian society, preserving the freedom of press and separating the domains of economics and politics.

Implications and Conclusions

Cronyism/corruption in India is not an isolated problem. It is an amalgamation of all the facets of Indian society. To rid India of corruption and cronyism the overhauling of Indian society is necessary and building new political, economic, and cultural institutions is imperative. These institutions have to be built on the historical strengths of the Indian society.

The license raj of the old socialist system bred crony socialism that led to inefficient regulatory regimes, cripplingly high compliance and transaction costs, a corrupt bureaucratic system, and a rent-seeking political system. Two governments, one by Narsimha Rao from 1991 to 1996 and the other by Vajpayee from 1998 to 2004, liberated the Indian economy and provided growth momentum and India began headlining news on the world stage. Unfortunately, the poor economic vision of the two governments since 2004 suggested that they did not learn anything from the previous economic success formula and they brought back the economic model of rigid state socialism championed by Indira Gandhi (Bhagwati and Panagariya, 2013; Gupta, 2013d; Singh, 2013a, 2013b). The Modi government has generated optimism and rekindled the hope that the Indian economy may do well and "achhe din" (good days) may be in store for the Indian masses. Modi does not seem to fall into the trap of crony socialism resulting from the socialist model that belongs to the Amartya Sen school of thought. He subscribes to the Bhagwati school of thought that emphasizes economic growth. There is a danger of rampant crony capitalism in this school of thought. Can Modi curb crony capitalism sufficiently such that it does not hurt the economy too badly? As Rajan (2014) rightly points out, the side effect of crony capitalism is income inequality and the middle-income trap. A good example of this is the USA where the middle class is shrinking with adverse societal consequences (de Rugy, 2012). Hope and optimism in Indian masses had been raised on many occasions before only to be shattered subsequently.

Robust institutions are the hallmarks of a great society. India as a society has to build all kinds of institutions: political, economic, cultural, and administrative. A social market economic model proposed by Resico (2013) that marries the free market principles of individual rights, republicanism, and the market with the social policy principles of human dignity, social justice, and solidarity may be the model of choice for future Indian economic policies. To curb cronyism, Indian society will have to foster the doctrine of ethical universalism in public life. An economic recipe recommended by English (2013) for India includes inculcating a liberal ethos in Indian society, preserving the freedom of press, and separating the domains of economics and politics.

One major threat to the derailment of the economic development agenda of the current government may come from the constituents of the BJP party who may mean well for India but may not necessarily have the right ideas, knowledge, expertise, and policies (Bhagwati, 2015). Modi, the BJP party, and its allies may need to be vigilant, open-minded, flexible and make every effort to seek and debate new economic ideas that lead to Indian prosperity (Singh, 2015a, 2015b). We conclude with a note of hope quoting from a recent article:

> Indians have the political freedoms, now they need economic ones . . . There is something noble about the faith and support millions of Indians continue to pose in their politicians. It is time they earned that trust, so that India can demonstrate that democracy and development are not mutually exclusive. (Tripathi, 2009: 52)

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5

Corruption in India: Understanding the Institutional Context to Counter It

Abhoy K. Ojha

Introduction

Corruption has been an issue of concern for most societies and India is no exception. The earliest references to corruption among government officials in India have been made in Kautilya's *Arthashastra* dated to the 4th century BC (Rangarajan, 1987), which contains several prescriptions to stop and reduce it. There is little reason to believe that corruption would ever have been completely eliminated since that time. Corruption was quite widespread in India under Mughal rule and also when it was a British colony. Even Mahatma Gandhi admitted that he had to compromise his principles and pay commissions, which may be termed grease money, when he practiced as a lawyer in the courts of Bombay and Rajkot in the early 1890s after his return from England (Gandhi, 1940).

More recently, Gandhi and Walton (2012) allude to crony capitalism in contemporary India when they examine the concentration of wealth among billionaires in India. Further, the interventions by the Supreme Court of India in high profile scandals such as the 2G spectrum allocation and coal block allocations indicate that corruption is present in high places even today (Patra, 2012). Recently, the governor of the Reserve Bank of India also highlighted the need to address crony capitalism in India. Further, most citizens believed that there is rampant corruption in the country, particularly in the government sector, reflected in India being ranked 85, with the rank of 1 for the least corrupt country, among 178 nations covered in the Global Corruption Perception Index prepared by Transparency International (https://www.transparency.org) in 2014. While some may quibble over the ranking of India relative to other countries which may be seen as more corrupt but ranked better

(Jenkins, 2006), there is no denying that there is considerable room for improvement in India.

This chapter focuses not so much on denying the existence of corruption in India, but on countering the continuation of the colonialist project to 'dehumanize' Indian society and deny its ability to have, or evolve, its own moral compass and address its own challenges. Max Mueller who lectured to the British officers preparing to sail to India to administer the colony during the 1860s–1870s was particularly disturbed by the negative view the trainee officers had of the people of India. In the preface of the second edition of the book *India: What can it teach us?*, Mueller (2000) noted that he faced significant antagonism in the first year for his lecture, 'Truthful Character of the Hindus', which made him consciously retain this without change even as he revised other lectures in subsequent years. He attributed the prejudice among the British, particularly among British administrators, toward India and Indians to the publication of James Mills' book *The History of British India*, which portrayed a view of India that suited the imperialists.

Unfortunately, the success of the colonial projects not only managed to convince those in the England (and the West) of the depravity of Indian society, it also distorted the self-image of the elite in the colonies. Nandy (1983) in his book, *The Intimate Enemy*, refers to the prejudices that people from the colonies developed about their own societies. He suggests that the elite of the colonies had become 'servile imitators and admirers' of the West performing 'gladiator-like acts' in front of appreciative masters located in the West to gain approval. He argues for the need for intellectuals in the colonies or former colonies to break the shackles and develop independent thought processes relevant to their contexts. In line with this broad thesis, the focus of this chapter is on opposing the solutions derived from neoliberal capitalist ideologies that have been suggested in the business literature, and suggesting that, as a society, India should, and is capable of, creating its own institutional arrangements to tackle the problems that are rooted in the Indian context.

This aspiration is no different from that of early European settlers in the then USA, which itself is a former colony. When the USA was colonized by the British, there was an attempt by the elite to replicate English practices in the new context. Since those early colonists considered themselves English, some of them thought that the laws as evolved in England should apply to them. However, since conditions in the colonies were different, different statutes had to be developed (Calabresi & Leibowitz, 2013). In other words, even in the USA, with its social, economic and legal system steeped in English roots, the statutes had to be changed to suit local 'interpretations' and conditions. The attempt in this chapter is to highlight the fact that the social and economic conditions, and, despite colonial influence, the legal systems in India, are noticeably different from England and the USA and that the provisions to address issues of corruption have to evolve locally rather than be thrust on the society by external agencies just because they have resulted in desirable outcomes in another society.

Corruption is supposed to have a negative impact on the economy (Ketkar et al., 2005; Khwaja & Mian, 2005; Imai, 2006; Mudambi et al., 2013). The simple prescription from a neoliberal perspective is the need to reduce the role of the government to allow market forces to prevent any supernormal profits that might hurt the economy. However, as Heston and Kumar (2008) argue, there is a need to closely examine the phenomenon of corruption in countries like India as it is among the economies that seemed to be growing despite the presence of corruption. Similarly, Lehrer and Delaunay (2009) suggest that the BRIC countries (Brazil, Russia, India, and China), which were to be the dominant economic bloc in the future, need to be examined differently. There is clear evidence that Japan, South Korea, Taiwan, Singapore and Indonesia and, more recently, China have had their governments favor certain corporations, public or private, at different stages of growth of their economies. Despite allegations of corruption in some of these countries, as reflected in the rankings by Transparency International, they seem to have done pretty well economically. On the other hand, many countries in Europe, particularly the Scandinavian countries, have very interventionist governments which have made doing business somewhat difficult but the countries have achieved economic growth while being less corrupt and more environmentally friendly than the USA (see Khatri & Ojha, Chapter 4 in this book).

In order to better understand the role of government in corruption and its impact on economic and social outcomes, a longitudinal study of 15 countries was conducted. Using long-term data on the GDP, the GDP/capita, the GINI index, the Ease of Doing Business Ranking, the Corruption Index and the Climate Change Performance Index of these countries, I argue that neoliberal arguments do not necessarily achieve the intended outcomes even in the USA, while countries adopting seemingly opposing institutions have done as well economically while being less corrupt, more caring, and more environmentally friendly societies. Hofstede's dimensions are used to argue that different societies have different social institutions that promote different attitudes to self, others in society and the environment and support economic growth and inhibit corruption and environmental damage. India will have to develop its own responses to the challenges it is experiencing based on its own societal institutions and attitudes to a variety of dimensions that provide meaning to being human.

Social construction of corruption

Ahuja and Yayavaram (2011) review the literature to develop a framework to understand supernormal profits or rents of firms. They argued that

> [m]onopolistic rents are the supernormal profits earned because the firm faces limited or no competition. Efficiency or Ricardian rents are earned when a firm is more efficient than its competitors . . . Quasi rents are the extra profits earned above what the firm's assets would earn in their next best use. Schumpeterian or innovation rents are the supernormal profits earned from the creation of new products or processes . . . Influence rents are the extra profits earned by an economic actor because the rules of the game of business are designed or changed to suit an economic actor or a group of economic actors. (Ahuja & Yayavaram, 2011: 1631)

They suggest that, conceptually, there are five types of market distortions that lead to some economic actors benefiting at the expense of others and provide an institution-based framework to understand how these distortions occur within contexts. However, in conclusion they argue that while their framework facilitated descriptive and predictive understandings, its normative applications may be 'ambiguous and potentially troubling'. Without getting into details, Ahuja and Yayavaram (2011) suggest that the strategy literature is replete with normative principles based on different perspectives that pay little attention to issues of morality and ethics. Prescriptions based on the understanding of industry structures, reflected in the Porter framework, advise managers on how to obtain monopolistic rents. Similarly, the resource-based view encourages efficiency rents, transaction cost perspective encourages quasi rents and evolutionary economics encourages innovation rents.

Much of the business and management literature seems to see these rents as legitimate rewards for entrepreneurs who have been able to identify these opportunities and these efforts are often portrayed as heroic initiatives at the heart of a capitalist system. However, Kotkin (2014) examines the acquisition of the Silicon Valley start-up WhatsApp by Facebook to provide another perspective. He argues that what has in fact been portrayed as a great reward for the engineers behind the firm is actually an outcome of market distortions that have tilted access to capital to a few well-connected individuals who get to choose the 'winners' through cronyism, even if it comes at the cost of societal welfare. However, the perspectives taken on influence rents are quite consistently portrayed as negative to societal welfare, particularly in the context of low-income economies, which itself may be an outcome of academic corruption.

Hodgson and Jiang (2007) argue that the concept of corruption is socially constructed, and has been distorted in the literature to focus on activities of the state. Similarly, Collins et al. (2009) admit that studying corruption, particularly across nations, was problematic as it is 'difficult to define, difficult to observe, and difficult to measure'. They suggest that the definition of corruption used in much of the research is controversial and almost by design provides results that suit the interests of the researchers and their sponsors while being unfair to some countries and cultures. They argue that often definitions of corruption used put developed economies in a more positive light than should be the case relative to developing countries normally painted in negative terms.

The overall corruption of the concepts affects interpretation of data. Statman's (2007) vignette study on acceptance of insider trading across different countries found that only 5% professionals in the USA and the Netherlands reported that they found the behavior of the protagonist in the vignette fair and/or acceptable, in comparison with 16% in Israel and Australia, 43%, 41%, 49% and 56% in Italy, Tunisia, India and Turkey respectively. Among students, the percentage was 36% in the USA and 76% in India, with other countries ranged in between. He, quite erroneously, attributed the differences to lack of ethics and trust in low-income countries relative to the USA. It is argued later in this chapter that a practice is considered unacceptable and hence corrupt in a society only if the social institutions and norms define it as wrong. Hence, what has been defined as corruption in the USA and also accordingly disseminated in society resulting in wider acceptance of the norm needs to be factored in while interpreting the data. Taking a different interpretation of the findings, what is worrisome is that despite all institutions in place and presumably widespread education about insider trading in the USA, 5% of professionals and 36% of students thought the actions in the vignette were acceptable.

As a consequence of an ideological tilt in the literature, the lack of economic growth in low-income economies is attributed to corruption, particularly influence rents or cronyism. There is also a focus on members of the government, both politicians and bureaucrats, for their role in cronyism. The role of government in the economic affairs in a country has been a matter of debate for long. Breen and Gillanders (2012) suggest that there is a consensus that governments should regulate markets to tackle the failure of markets but the differences over the extent of regulation persists. Holcombe (2013) acknowledges that the role of governments may be occasionally justified but was convinced that a big role for the government in the economy was the source of corruption and the only way to rid society of corruption and prevent entrepreneurs who believed in free markets from also indulging in corruption, was to reduce the size and role of government.

There is a considerable body of literature that is consistent with this argument. Mudambi et al. (2013) argue that the increased role of government leads to higher levels of corruption as well as lower levels of foreign direct investment. Fisman and Gatti (2002a), from a study across countries, suggest that decentralization in government expenditures was associated with lower levels of corruption. In another study within the USA, Fisman and Gatti (2002b) found a positive relationship between federal transfers to states and levels of government corruption in the states. Both studies essentially stressed the need to reduce the role of government in the economy. Faccio's (2010) cross-national study concludes that companies that were politically connected performed better in terms of market share and ability to raise debt even if their 'real' capabilities to perform were not as good as some other companies. The effects were stronger when the linkages were between individuals at high levels in the firm and in the government, particularly in countries that ranked higher in corruption. Faccio (2006) indicates that while connected firms got preferential access to government organizations and government contracts, better taxation terms or favorable treatment by regulators, politicians themselves extracted rents and firms benefited only if the favors outweighed the cost of those favors.

It is not difficult to accept the argument that interventions by politicians and bureaucrats distort free markets and on occasion hurt societal welfare. However, sometimes the neoliberal ideological position is stretched to question any role of government in the economy. Two recent articles in *The Economist* (August 30, 2014a, 2014b) report on out-of-court settlements by large US corporations with various arms of the US government, for example, a $17 billion agreement with the Bank of America, a $1.2 billion settlement with Goldman Sachs and a $300 million deal with Standard Chartered. Rather than view these examples, and many more reported in the articles, as illustrations of rampant violation of laws by big and famous corporations, the central argument was that the corporations were making these settlements to avoid harassment from a government that had budget deficits and would do anything to get corporations to contribute to the reduction of the deficits. It is quite ironic that many of these organizations were beneficiaries of government bailouts in the last financial crisis.

In short, despite the rhetoric of free markets, organizations of all sizes and hues are prepared to have government participation in economic affairs as long as it helps them obtain rents not otherwise accessible to them. Corporations, governments and supportive economists always find 'sound' arguments to justify the intervention. Hence, a simple analysis of the role of government in a low-income economy can be potentially problematic if supporters of government in those economies are not allowed to select the exceptions that can be made. Recalling Ahuja and Yayavaram's (2011) analysis, I argue that within the context of low-income economies, the first four distortions favor the multinational corporation (MNC) and hence do not attract much negative attention in the business literature despite their negative impact on societal welfare. However, firms from low-income economies have the ability to counter the effect of the four distortions that favor large MNCs in their home countries by influencing the legislation in their country to reduce and/or neutralize those advantages. Since the local 'rules of the game' do not allow certain MNCs to fully exploit the market distortions they have already created, the business literature seems to focus disproportionately and negatively on the impact of influence rents on societal welfare. Efforts to create a level playing field for local organizations are portrayed as cronyism with local industrialists exploiting their proximity to politicians to create influence rent at the cost of societal welfare. There is rarely an acknowledgement that it might be legitimate for a government in a low-income economy to protect domestic industry from the monopolistic practices of MNCs.

A significant amount of the literature on cronyism has focused on East Asia and Southeast Asia. These societies have had a long tradition of relying on familial and community networks to conduct business affairs. Hence, they provide a fertile ground for 'fishing' for evidence that can categorize business practices in these societies as corrupt based on lenses developed in the West. Rosas (2006) argues that government policies, particularly those related to crony capitalism, may be influenced both by external pressures as well as pressures from domestic needs and institutions. Fisman (2001) developed a method of estimating the value of political connections by examining the changes in valuation of shares of a set of companies with links to the Suharto regime in Indonesia in response to positive or negative news related to Suharto. Imai (2006) found evidence of powerful business groups in Thailand having familial ties with powerful politicians. Similarly, Collins et al. (2009) found evidence of cronyism in India as managers indicated a willingness to seek influence rents when they had familial ties with government officials even if they appreciated that some of these acts were illegal and harmful to society.

Aligica and Tarko (2014) acknowledge that cronyism plays a role in high-income economies also. However, they provided a unique twist to the good and bad argument essentially painting the governments in high-income economies as 'honest' and those in low-income economies as 'dishonest', while portraying corporates in both contexts as pragmatic. They argued that crony relations in high-income economies restricted the ability of governments to provide opportunities for influence rents and hence prevented rent dissipation. On the other hand, they suggested that in low-income economies corporations had to maintain crony relations with powerful people in the government to secure property rights as in the absence of law powerful elements in the government may confiscate economic assets.

Heston and Kumar (2008) suggest that corruption in India should be segregated into three types. The first, referred to as petty or retail corruption, is the corruption of low-level government officials that is quite visible to and commonly experienced by citizens. These usually involve payments to officials to permit minor violations of the law or many times 'grease' money to have the officials do what they are supposed to do anyway. For example, paying a bribe to avoid a penalty for a traffic violation and bribing an official to expedite the processing of a driving license are instances of petty corruption. This type of corruption is absent in high-income economies, while is it is quite common in low-income economies, including India. It is so common and 'accepted' in India that it does not attract too much attention from either the media or law enforcement agencies. However, this type of corruption does contribute to the country's ranking on the Transparency International list.

The second type is systemic corruption. This is less visible to citizens and others, including the media, as it involves businesses and firms bribing government officials and/or politicians to get them to be soft on an 'unreasonable' regulation or to overlook a regulation that is violated. Given the plethora of regulations, many very antiquated, it is quite common for firms to bribe officials even if they are following the regulations to avoid harassment based on some neglected clauses of the regulation. Like petty corruption, this type of corruption is less likely to occur in high-income economies which have adopted systems compatible with markets. However, this type of corruption is unlikely to impact the rankings provided by Transparency International as very few people may be involved and/or aware of this corruption.

The third type of corruption is grand corruption. This corruption involves high-level politicians, government bureaucrats, senior executives and promoters of large corporations, both domestic as well as multinational, and is based on influence rents or crony capitalism. It may be associated with government expenditures such as public works or defense purchases that favor certain organizations or could include tweaking policy to benefit an organization. This corruption is not visible to citizens and also not normally visible to the media However, this type of grand corruption is prevalent across high- as well as low-income countries and oftentimes, as the case in India, MNCs are as involved in grand corruption. However, in a democratic society with multiple political parties and active citizen organizations, people become aware of the existence of cronyism and this affects the corruption ranking. Many citizens in the high-income economies believe that there is little or no corruption in their society as they do not experience retail corruption, are not aware of systemic corruption, and are aware of only some of the grand corruption that prevails in their society. In countries like India, experience with petty corruption prejudices the views of citizens against the government and they are pretty quick to attribute societal failings to systemic and grand corruption in government which gets reflected in corruption rankings.

In the next section, it is argued that different countries and societies have opted for different institutional arrangements to support economic activities, and have achieved varied outcomes in terms of wealth creation, wealth distribution, levels of corruption, and damage to the environment.

Societal aspirations and political and economic institutions

Much of the normative literature that examines issues of corruption neglects the fact that societies have taken different paths to the development of their economies based on variations in societal aspirations. To the extent that some of the literature acknowledges the differences, the underlying assumption is that over time the economies will converge on the systems that prevail in the West, particularly in the USA

(Adler, 2014). Lehrer and Delaunay (2009) suggest that the Organisation for Economic Co-operation and Development (OECD) was the dominant institution that provided the blueprint through which neoliberal market capitalism was to be implemented across economies. Ironically, institutionalized corruption was quite rampant during the economic ascendancy of the USA during the late 19th and early 20th centuries (Jenkins, 2006) just as it is in some of the Asian economies, including India, today. Carney (2008) describes the USA's efforts to impose its economic system on Japan after World War II and shows how the country reverted to its traditional system of an administered economy when the USA chose to focus instead on security issues due to the Cold War. Similarly, South Korea had a government that actively distorted the markets and openly supported certain business groups. To varying degrees, Taiwan, Singapore, Indonesia, Malaysia, the Philippines and Thailand and, more recently, China and Vietnam have also accepted market mechanisms but with a strong presence of the state as a player in the economy. He suggests that in these countries, the intervention of the state was based on the notion that the state was in the best position to guide the national development agenda and stand up against exploitation by special interests. He also suggested that in societies in which there was a lot of societal and economic flux, corporations often established patrimonial relations with the government in order to protect economic interests. Until recently, India also had a strong role for the government in the economy.

Adler (2014) argues that capitalism has three distinguishing features:

> (a) market competition among profit-driven firms; (b) wage-based employment under hierarchical control within these firms; and (c) limited government authority over these firms' activities. (2014: 207)

These features offer certain benefits to society. Market competition forces firms to be innovative and this encourages them to be dynamic and creative to sustain growth. Wage-based employment provides people opportunities to be engaged in activities of their choice. Finally, limited government allows firms and individuals to contract with each other based on mutual benefits without external constraints. However, Adler suggests that the same features may result in some disadvantages. While markets encourage dynamism, they are also very unstable. Crises in the market can disrupt economic activity leading to tremendous difficulty for those affected; market failures can also result in oligopolies, hurting societal welfare. Wage-based employment offers freedom but often forces people into modern-day slavery (Crane, 2013) as, in a declining economy, many people are forced into exploitative employment relationships. Finally, limited government also restrains the government from guiding economic development even when the harsh consequences of market failure and damage to the environment are clearly visible. Governments are unable to intervene on behalf of the weak and the marginalized since a potential backlash from corporations may make matters worse for the government and society.

Adler (2014) suggests that different societies adopted different forms of capitalism. In order to tease out the differences, he suggests that the choices can be differentiated based on two dimensions: the role of government and the role of community. The first captures whether the economic choices in a society are left to the market forces or driven by government authority. The second captures whether economic actors are expected to operate entirely by self-interest with little or no attention to community or whether their actions are expected to reflect a sense of obligation or reciprocity with the community in which they operate. He suggests that different countries/societies had opted for different positions on the role of government and the role of community in the functioning of business organizations. Figure 5.1 shows the framework that organizes the variety of business systems along the two dimensions. Each of these systems is a product of social and cultural institutions in the country/society and also of history and circumstance. Each of them has its strengths and weaknesses.

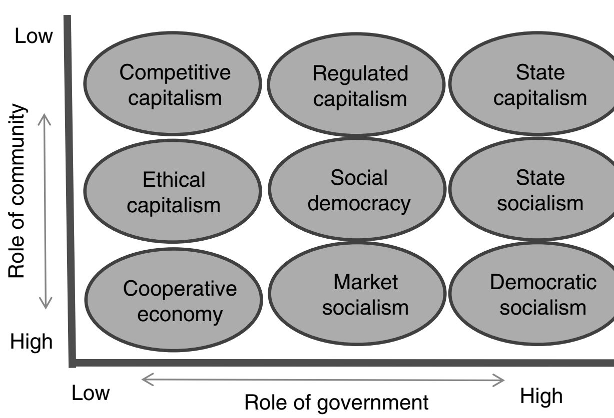

Figure 5.1 Variety of business systems

Source: Adapted from Adler (2014)

Adler (2014) indicates that the USA followed competitive capitalism in which, at least in theory, neither the government nor the community had a significant role in guiding business practices. In other words, the USA seems to have selected the cell that is closest to the economic principles defined by neoliberal economists, the idea of pursuing profit as the only goal of a firm and small government that has a limited or nominal role in the economy (Holcombe, 2013; Macey, 2014). Also, economic principles trump the voice of the community or society in the conduct of business. In other words, there is either no role or a limited institutionalized role for community issues to be factored into business decisions. Jensen (2011) presents a positive view of how an organization operating in such an environment would serve the needs of society without being subjected to government or societal oversight.

Adler (2014) suggests that much of Europe, including France and Germany, had adopted regulated capitalism in which governments play a modest role in guiding the economic agenda while firms were still allowed to pursue profits without special attention to community. Hence, despite the community not being in a position to influence business decisions, they had an opportunity to influence business through intervention by the government. Sweden followed social democracy with modest intervention by the government and a modest orientation toward the community. Firms in Sweden accept the role of government in defining the 'rules of the game' and are sensitive to the need to factor in the community in which they operate.

Some Asian countries adopted state capitalism and South Korea is a very successful example of a state being involved in cronyism with little or no concern for community but the outcomes on most indicators of development have been good. China is also an example of state socialism. While many might criticize China for the existence of cronyism, it has been most successful in lifting large masses out of poverty in the shortest period. Adler suggests the former Yugoslavia is an example of market socialism and Mondragon an example of cooperative markets. The countries formed out of the former Yugoslavia have made varied choices but their options have been constrained by the business system that prevailed earlier. India can be described as following democratic socialism before 1991 and attempting to move to the middle position on both dimensions during the period of liberalization and institutional reform since 1991.

Ironically, Adler (2014) did not suggest an example of ethical capitalism and, as mentioned above, the cooperative economy is the choice made within a province of Spain. In other words, it is difficult to find an example of a country that has paid a modest or high level of attention to the community without strong intervention by the state. Despite suggestions by Freeman (1984), Porter and Kramer (2006) and Porter and Kramer (2011), it appears that the possibility of having socially responsible organizations is a myth (Devinney, 2009).

Lehrer and Delauney (2009) present a different framework that also supports the notion that countries seemed to have made different choices in terms of economic and societal institutions to coordinate business activity. Like Alder's (2014) framework, one of the dimensions in their framework referred to the role of the state relative to that of the market in ensuring economic coordination. The second dimension referred to the role of the state relative to civil society in ensuring societal coordination. Figure 5.2 presents the framework.

There are two choices that have relied entirely on the state for one type of coordination but not for the other. Militaristic capitalism refers to a situation in which there is no role for civil society in societal coordination with the state playing a major role. On the other hand, the state does not have a role in economic coordination with full reliance on markets. The case of South Korea in its early years of development might be an example that fits this description. Even as the government encouraged market economics, it played a role in suppressing civil

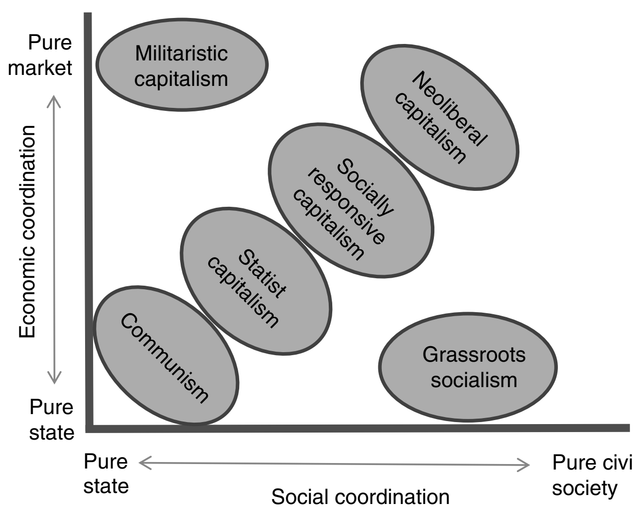

Figure 5.2 Economic and social coordination of business
Source: Adapted from Lehrer and Delaunay (2009)

society from having a voice in the running of the economy. On the other hand, grassroots socialism provides a strong role for government in economic coordination and a strong role for civil society in terms of societal coordination. The economic system in former Yugoslavia would probably fit this description.

The one choice that relies on the state for both forms of coordination was communism. It refers to the context in which the state was all powerful in terms of both economic and societal coordination. In such a situation, there was no reliance on market forces for economic coordination nor was the reliance on civil society to assist with the social coordination associated with the business system. In other words, the state had the power to decide what was produced and sold and also who worked for whom and in what roles. The cases of Stalinist USSR or Maoist China may be good examples to represent this choice.

The other choices seem to balance the role of government along the two dimensions. Statist capitalism refers to the context when there is a relatively strong but not absolute role for the state in economic coordination as well as a relatively strong but not absolute role for the state in societal coordination. Lehrer and Delauney (2009) suggest France as an example of a country in this situation. As discussed earlier, France has a relatively strong role for the government in the management of its economy. This is manifest in the presence of high levels of regulations as well as the presence of government-owned organizations in the economy. Socially responsible capitalism refers to the context of a balance between the state and market in economic coordination and also a balance between state and civil society in societal coordination. Sweden probably fits the description perfectly.

Neoliberal capitalism is the label one can provide to the context in which there is a complete reliance on markets for economic coordination and a complete reliance on civil society for social coordination with little or no role for government on either dimension. The US economy comes closest to mimicking the conditions described for this context by Leher and Delauney (2009). There is a limited role for government in economic and social coordination with reliance on markets for economic coordination and civil society for social coordination. Lehrer and Delauney (2009) suggest that India was probably close to grassroots socialism before 1991 and was increasing reliance on markets for economic coordination since the process of liberalization started. Depending on the extent to which there is a reliance on civil society for social coordination in the future, the economy will edge toward socially responsible capitalism or statist capitalism.

In order to build on the arguments of Adler (2014) and Lehrer and Delauney (2009), the performance of 15 countries on some indices over long periods of time was examined. This includes the USA and UK as they seem to have made similar choices and much of the external prescriptions for India are provided by scholars from these two countries. Sweden, Germany and France were included to complete the list of high-income economies as they represented choices that were different from the USA and UK and more similar to each other on several parameters. Then Brazil, Russia, China, South Africa and Nigeria were included as these were countries that are expected to drive future global growth. Indonesia, Malaysia and Mexico were included as they were large low- to medium-income economies that are expected to be bigger than several high-income economies in the future. South Korea was also included as it is a country that has moved from a low to a high-income economy in the shortest time and is today part of the OECD.

The indices included in the study were the Corruption Index as reported by Transparency International as it was expected to track the level of corruption in a country. Ease of Doing Business Ranking as reported by World Bank was included as it has been argued that much of the corruption and crony capitalism is due to the presence of government interventions in the economy and the index captures the extent to which government regulations and processes create 'barriers' to free markets. Gross Domestic Product, Gross Domestic Product per capita, and GINI index as reported by the World Bank were included to capture trends in economic development important from the perspective of creation as well as distribution of wealth in an economy. Climate Change Performance Index as reported by German Watch was included as an indicator of how much the society or country cared for the environment.

A study of the trends of GDP shown in Figure 5.3 clearly indicated that the economy of the USA was the largest. It was the largest in 1961 and over the years the gap between it and the other countries in the analysis increased significantly. Germany, France and the UK had grown but relatively modestly. The other economies that were small continued to be very small on a relative scale. The recent performance of China was the only exception and most scholars would attribute this to the adoption of market mechanisms in the country. A quick conclusion might be that all low-income countries, including India, should adopt the market systems in the USA (competitive capitalism or neoliberal capitalism) to achieve economic growth.

However, trends in the GDP per capita as shown in Figure 5.4 suggested that there might be other conclusions that may be drawn.

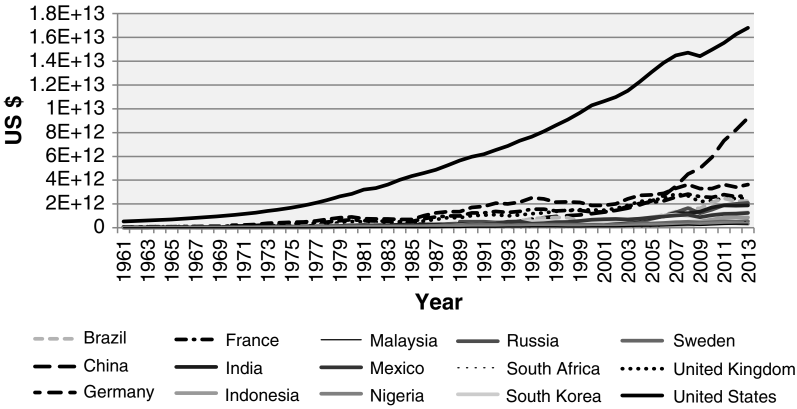

Figure 5.3 Gross domestic product, 1961–2013
Source: World Bank website

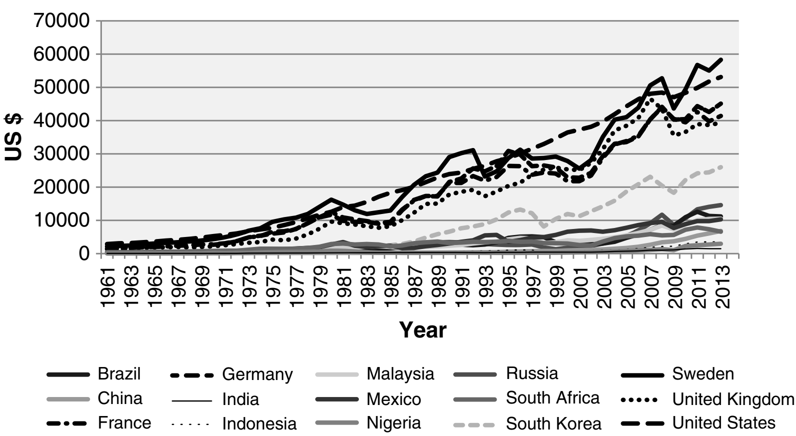

Figure 5.4 Gross domestic product/capita, 1961–2013
Source: World Bank website

Sweden had a better GDP per capita and Germany, France and the UK were not far behind. Also, South Korea seemed to have made rapid progress in terms of this index. Assuming that this is a good measure of material well-being, the systems in these countries seem to be doing pretty well in terms of providing for their citizens rather than just ensuring growth in the economy. Hence, one might be able to argue that low-income economies attempting to encourage economic growth might benefit from an understanding of the systems in five other countries, particularly Sweden on one end and South Korea on the other end of the high-income countries. The success of these countries suggests that there may be multiple paths to economic growth.

A perusal of the GINI index as shown in Figure 5.5 seems to tilt the arguments away from borrowing the economic systems from the USA. Quite clearly, Sweden was doing very well in terms of maintaining an equitable distribution of wealth even as it had the highest GDP per capita in the comparison countries. Data on the GINI index for South Korea were not available, but USA did the worst among the high-income countries for which data was available, and worse than even India in terms of fairness in the distribution of wealth in society. South Africa and Brazil, two BRICS countries, often seen to be doing well economically did not fair too well on this index. In short, India might have more to learn from the experience of Sweden and Germany than the USA.

A significant explanation for economic growth in the USA is that doing business has been made very easy. Figure 5.6 suggests that USA had consistently been ranked the best country to do business. Among the other high-income countries in the comparison, France was the only country to have a relatively low rank. While Sweden and Germany seemed to provide contexts in which it may be more difficult to do business, they were still ranked relatively high. It was clear, however, that

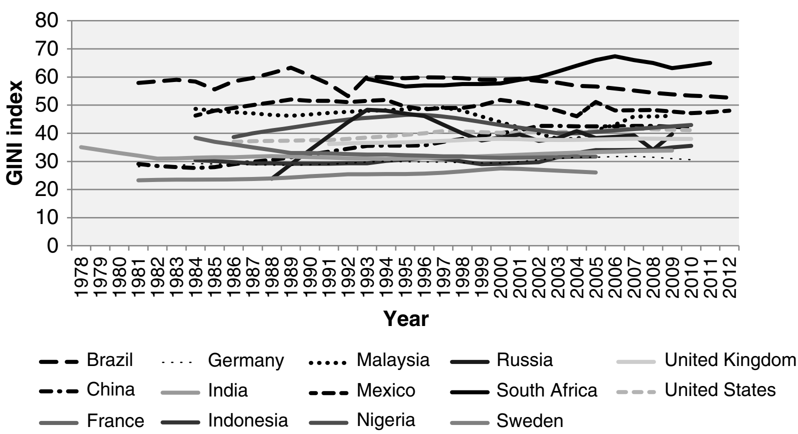

Figure 5.5 GINI index

Source: World Bank (missing data was replaced with averages to ensure smooth curves)

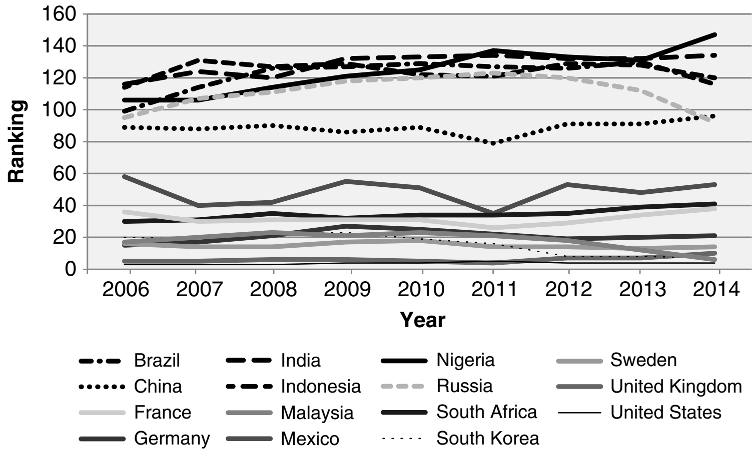

Figure 5.6 Ease of doing business rankings, 2006–2014
Source: World Bank

the government played a more significant role in guiding economic activity in these countries. If one was to take this in conjunction with GDP per capita and GINI index trends, Sweden and Germany reflected better choices of institutional arrangements relative to the USA, particularly from the perspective of a low-income economy such as India making choices in terms of institutional arrangements to adopt.

Despite an unequal distribution of wealth, one could argue that the USA institutions have the advantage of being based on 'small' government and hence the level of corruption should be low. However, the trends in the Corruption Index shown in Figure 5.7 suggest that all the high-income economies have lower levels of corruption than the low-income economies but that Sweden, Germany and the UK do better than the USA on this dimension. To some extent, this does deflate the argument in favor of small government. Rothstein (2013) attributes the difference in levels of corruption to the levels of trust in society rather than to size of government. Societal trust provides the informal institution to care for all in the community rather than be obsessed with caring for oneself because the rest of the community cannot be trusted. It is this societal trust that probably allows Sweden and Germany to make choices in terms of economic institutions that are different from the USA. Neoliberalism is so much based on ideas of distrust of government and larger society that people are prepared to indulge in corrupt acts to enhance self-interest despite no real pressing need.

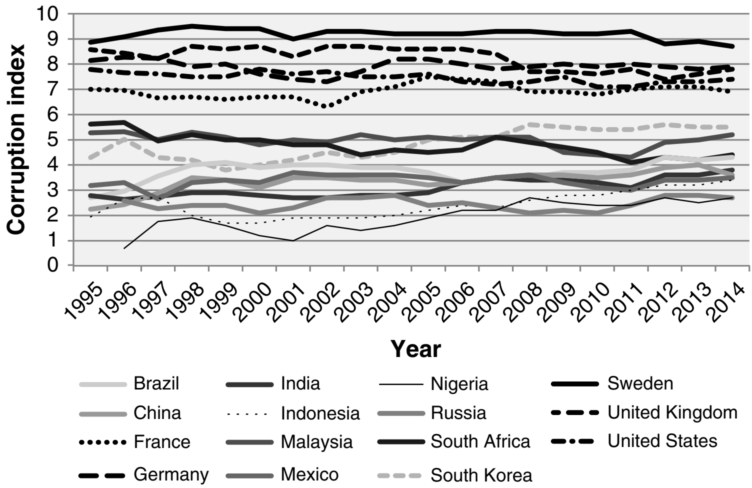

Figure 5.7 Corruption index, 1995–2014
Source: Transparency International

Another parameter of interest for societies today is the extent to which an economic system takes care of the environment as it pursues economic growth. As per trends on Climate Change Performance Index in Figure 5.8, the USA had the worst rank among the high-income countries with the exception of South Korea, which probably had pursued economic growth at the cost of its environment. Even China which is often criticized for neglecting the environment had improved significantly and its score was only marginally worse than that of the USA. The other high-income countries, Sweden, the UK, France and Germany, did much better than the USA. It would be fair to conclude that some of this was an outcome of government intervention in the economy and the poor score of the USA was due to the lack of intervention of the government.

In short, there was no evidence that the choice of 'competitive capitalism' with a low role for government and low role for community or 'neoliberal capitalism' was leading to a better society other than in terms of growth on GDP. Of the four high-income economies (other than the USA), Sweden, Germany and the UK had consistently scored better than the USA on the Corruption Index despite scoring worse on the Ease of Doing Business Rankings, and Sweden, Germany and France scored significantly better than the USA on the GINI Index and Climate Change Performance Index. If keeping corruption and income disparities low

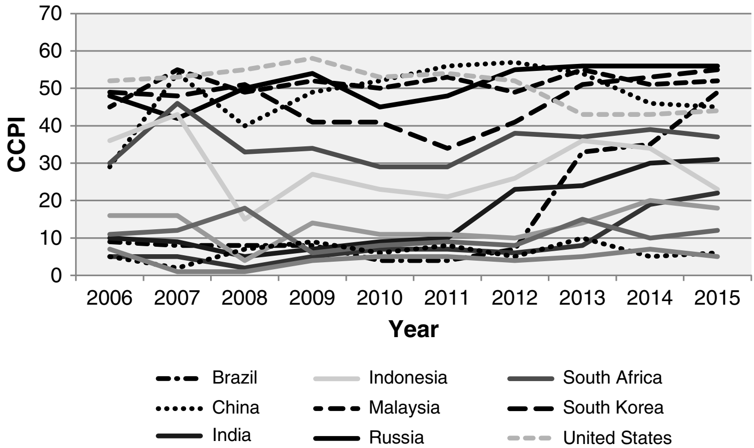

Figure 5.8 Climate change performance index
Source: German Watch

even as a country pursues economic development is a societal choice, Sweden and Germany seem to be better role models than the USA. When the need to protect the environment is included, it seems that these two countries might be better 'north stars' than the USA.

Alder (2014) emphasizes the need to better understand the link between institutional choices of societies and the outcomes they desire. He suggests that state capitalism or state socialism might offer the 'right' institutional environment for low-income economies looking for rapid industrialization. He also argues for the need to explore alternative enterprise governance models whose objectives go beyond shareholder wealth maximization and suggested a greater focus on cooperative forms of organization and community-based governance models. Similarly, Lehrer and Delauney (2009) argue that India and other BRIC economies will have to adopt a contemporary version of statist capitalism as the rapid economic growth was likely to test the capacity of the environment and society to bear the burden of growth and combat corruption with greater transparency.

Journey to a corruption-free Indian society

An institutional perspective emphasizes that morality is socially constructed and 'moral communities, organizations and individuals make up the components of the nested system' in which corruption occurs (Shadnam & Lawrence, 2011). de Vaal and Ebben (2011) argue that the relationship between corruption and economic growth depends on the informal and formal institutions in the context. Estrin and Prevezer (2011) highlight the role of interaction between informal and formal institutions as complementary, accommodating, substitutive or competitive, as they support and/or inhibit corruption. Similarly, Li et al. (2008) argue that social institutions should never be ignored in the struggle against corruption. Ahuja and Yayavaram (2011) also suggest that

> [e]ffective free markets need a multitude of institutions, which are often difficult to develop and expensive to run and need to interact with each other and with firms in complex ways to deliver (the presumptive) benefits of wealth and welfare. (Ahuja & Yayavaram, 2011: 1632)

Carney (2008) indicates that there were strong coercive and normative pressures from governments of powerful countries and multilateral agencies controlled by them, such as the International Monetary Fund, World Bank and other development agencies to get low-income economies to adopt 'global best practices'. He also suggests that these efforts face obstacles from vested interests and financial market retardation. More importantly, he suggests that path dependence and multiple optima were other obstacles to the adoption of the practices thrust on low-income countries.

Williamson (2000) had argued that societal norms rooted in informal institutions, customs, traditions, norms and religions of a society were often based on non-calculative assumptions, were spontaneous and may take 100 to 1000 years to change. Economic norms were embedded and constrained by the societal norms but might be changed in 10 to 100 years. In turn, governance norms within organizations were embedded within the economic norms and might be changed in 1 to 10 years. Actions at the level of individual managers were embedded within this context but are subject to continuous change. There is no reason to believe that institutions developed in the West, particularly the USA, will be compatible with social institutions in India. Echoing a similar sentiment, Rothstein (2013) suggests that there was no evidence that other societies will be able to adopt the economic institutions informed by neoliberal economics without a problem. Similarly, Breen and Gillanders (2012) argued that 'top down' institutional reforms were unlikely to work like a 'magic bullet' unless adequate attention was paid to other related institutional changes to incentivize compliance and increase costs of corruption. Misangyi et al. (2008) emphasize the importance of disrupting institutional logics that support corruption and creating new identities and practices compatible with the new institutional logics to reduce corruption. In a recent article, Chen et al. (2015), based on their study of the sharing of private information within networks, argue for the need to include historical and social structures in any analysis to understand that economic activities are embedded in the social context (Billing & Farro, Chapter 6 in this book).

Hofstede's cultural dimensions provide a simple set of indicators that allow one to make an argument that social institutions in different countries are divergent. Power distance is defined as 'the extent to which the less powerful members of institutions and organizations within a country expect and accept that power is distributed unequally'. Individualism is defined as 'the degree of interdependence a society maintains among its members'. In individualist societies, people look after their own interests and those of their immediate family while in collectivist societies people are expected to have the interests of a larger 'in-group' in mind in their decisions and actions. Masculinity is defined as the extent to which a 'society is driven by competition, achievement and success'. On the other hand, feminine societies value caring for others and standing out in terms of achievement and success is not as valued. Uncertainty avoidance attempts to capture how societies deal with the future. It is defined as the 'extent to which the members of a culture feel threatened by ambiguous or unknown situations'. In high uncertainty avoidance societies, ambiguity of the future leads to anxiety. Pragmatism is a dimension that captures 'how every society has to maintain some links with its own past while dealing with the challenges of the present and future'. More pragmatic societies are accepting of change while less pragmatic (or more normative) societies attempt to maintain old traditions. Indulgence is defined as 'the extent to which people try to control their desires and impulses'. Indulgent societies have a willingness to enjoy life and have fun and give importance to leisure time while restrained societies attempt to control impulses and desires.

Table 5.1 shows the extent of variation of the comparison countries along six dimensions. The table suggests that each of the countries has a unique pattern of institutions. A simple comparison of India with the USA suggests that these are significantly different societies. Power distance in India is much higher than in the USA. Indian society is significantly less individualistic than the USA while it is quite close in terms of masculinity and uncertainty avoidance. The US society is significantly more pragmatic and more indulgent than Indian society.

Table 5.1 Hofstede's dimensions

	Power distance	**Individualism**	**Masculinity**	**Uncertainty avoidance**	**Pragmatism**	**Indulgence**
Brazil	69	38	49	76	44	59
China	80	20	66	30	87	24
France	68	71	43	86	63	48
Germany	35	67	66	65	83	40
India	77	48	56	40	51	26
Indonesia	78	14	46	48	62	38
Malaysia	100	26	50	36	41	57
Mexico	81	30	69	82	24	97
Nigeria	80	30	60	55	13	84
Russia	93	39	36	95	81	20
South Africa	46	65	63	49	34	63
South Korea	60	18	39	85	100	29
Sweden	31	71	5	29	53	78
UK	35	89	66	35	51	69
USA	40	91	62	46	26	68

Source: The Hofstede Centre website.

Using this variance along select dimensions, it can be concluded that societal institutions, and hence societal priorities, in these two countries are different. It is quite unlikely that economic institutions embedded in US society are likely to produce the intended results in India. Also, high power distance and low individualism may not allow the same degree of opportunities and incentives for civil society to oppose corruption the way they have been able to do in the USA. Hence, some role for the government is essential.

On the other hand, India is also significantly different from Sweden, the country that is argued to have achieved a better society than the USA. Similar to the comparison with the USA, the power distance in India is significantly higher and individualism is much lower than in Sweden. However, masculinity in Sweden is significantly lower while uncertainty avoidance is less than in both USA and India. India and Sweden seem to be comparable on pragmatism but Swedish society is more indulgent than Indian society. Again, because of the noticeable variance in societal priorities, it is unlikely that the economic choices that have worked for Sweden will work for India. Also, given the differences, it is unlikely that the remedies against corruption in Sweden will work in India. Hence, it is easy to draw the inference that India can learn from the experience of others but has to make its own choices in terms of institutional arrangements compatible with its context and also that allow it to achieve the desired outcomes including tackling corruption.

Further, within India there is a growing group of scholars who are opposing the imposition of neoliberal institutions on India. Shah (2009) suggests that some of the opposition is based on the notion of India as a postcolonial state that should reject the changes thrust by the former colonizers or interests aligned to them. Others oppose the new institutions because they do not reflect the localized practices well embedded in Indian society. Shah argues that an understanding of India's 'political society' is important to assess the acceptance of these institutions. Based on his analysis of corruption in the state of Jharkhand, Shah (2009) claims that corrupt practices are embedded in different motivations of economic actors and the disconnect between moral reasoning for local practices relative to those that inform externally imposed institutions and also the disconnect between moral reasoning and the legality of actions leads to failure of anti-corruption initiatives.

Beckert (2010) argues that externally driven institutional change occurs if existing institutions in a country have been discredited and a powerful external actor can thrust a new institutional design. However, Gertler (2010) suggests that institutions were products of evolutionary trajectories influenced by other national and provincial institutions, local political dynamics and the agency of affected individuals and organizations and under normal conditions externally driven institutional change was less likely to succeed. Consistent with this argument, Pillay and Kluvers (2014) highlight how anti-corruption legislation in South Africa had not been successful in curbing corruption as it was not adequately supported by the institutional environment to weaken the institutional logics that supported corruption. Taking the argument even further, Adegbite et al. (2012) suggests that while activism by shareholder associations had been able to contribute to good governance practices in the institutional contexts in which they were developed, their implementation in Nigeria was bad for corporate governance as well as political activity in the country. In other words, a practice that had positive outcomes in one context actually made matters worse in another context in which enabling institutions were not present.

Quah (2001) analyzes the efforts to fight corruption in China, India, the Philippines and Mongolia to identify why they have not been as successful as Singapore and Hong Kong in rooting out corruption. He identifies lack of political will as a major reason. Further, in India the initiative did not work as the anti-corruption agencies did not have adequate powers and had overlapping responsibilities. This study concluded that the political system in India was not serious about corruption and did not have the political will to put into place empowered agencies to tackle corruption. Inherent in the study was the view that the top down approach which worked in Singapore and Hong Kong would not work in other Asian countries, including India. However, the little success that has actually been experienced in India is based on a bottom-up activism by civil society with some enabling legislation that has been initiated from the top.

Heston and Kumar (2008) suggest that as awareness of corruption has increased, different arms of the governance system such as the Election Commission and the Supreme Court have been able to make considerable headway in curbing corruption by pushing initiatives from the top. On the other hand, Mistry (2012) describes how e-governance initiatives for various government programs in India enabled transparency and accountability and helped reduce corruption by involving citizen groups. Similarly, Agrawal (2012) found that the implementation of the Right to Information Act in 2005 had resulted in greater transparency and reduced corruption with government officials being more inclined to be responsive to the need to address issues of corruption. Jenkins and Goetz (1999) document how citizen groups had used the Right to

Information Act to reduce corruption. It appears that a unique combination of top-down anti-corruption legislation and state initiatives along with the bottom up civil society movements have been quite successful in beginning the journey to curb corruption. The hope is that going forward the right combination on remedies compatible with the institutional contexts will be implemented to make the country corruption-free.

Conclusion

I have argued that it is quite well accepted that corruption levels in India, even as seen by its own people, are very high and something needs to be done to reduce them. However, the simple neoliberal solution of reducing government and relying on market forces and civil society activism to address issues of corruption which has worked reasonably well in other contexts may not work in India. There is a need to develop institutional arrangements compatible with the local contexts to address the challenge.

Every society or country has made choices in terms of social and economic institution to support business activity in order to meet societal aspirations. They have resulted in different levels of performance in various parameters of interest, including wealth creation, wealth distribution, corruption, and environmental damage. All institutional changes are path- dependent and while India can learn from the experience of others it cannot borrow the institutions from an incompatible society. Policy makers and anti-corruption activists have to be aware of the aspirations of the people, what is feasible within the institutionalized contexts and then build on the experiences of other countries to evolve its own institutional arrangements to reduce and ultimately eliminate corruption in government spheres and society.

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6
Cultural Correlates of Crony Capitalism in India

Tejinder K. Billing and *Andrea Farro*

Introduction

India experienced unprecedented economic growth since economic reforms were launched in 1991 in the wake of India's balance of payment crisis. These economic reforms adopted the free market philosophy and aimed to eradicate the License Raj. Although the Indian economy has improved significantly since the reforms, India still remains a difficult place to start and run a business. In a report titled 'Doing Business' by the World Bank, India ranked 142nd out of 189 countries in the favorable institutional business environment (World Bank Report, 2014). India is ranked even lower (156th out of 189 countries) when it comes to the 'starting business' indices of this report. Similarly, India's arduous business climate is echoed in its low ranking on the Global Entrepreneurship Development Index (75th out of 120 countries), which examines the entrepreneurship ecosystems (mix of attitudes, resources, and infrastructure) of countries across the globe.

Despite India's poor rankings on the above indices on business environment, the Indian economy is growing rapidly and is home to the largest number of billionaires in the world, per trillion dollars of the gross domestic product, after Russia (Gandhi & Walton, 2012). The Reserve Bank of India's governor, Raghuram Rajan, voices his concerns 'three factors – land, natural resources, and government contracts or licenses – are the predominant sources of the wealth of our billionaires. And all of these factors come from the government' (Bajaj, 2012, p. B3). These contrasting facts suggest that Indian capitalism works in favor of those who are powerful and well connected with governments. It not surprising that India tops *The Economist*'s Crony Capitalism Index.

While many things can be blamed for the rampant crony capitalism in India (e.g., British imperialism, the License Raj, etc.), we are particularly interested in understanding what role cultural values play in fostering crony capitalism. Although there is abundant support for the relationship between culture and corruption (Barr & Serra, 2010; Fisman & Miguel, 2007; Lambsdorff, 2006; Treisman, 2000; Uslaner, 2004), scant attention has been given to how culture impacts different economic systems. Mathers and Williamson (2011) examine whether capitalism performs better in certain cultural contexts. The results of their study show that capitalism performs better in a culture that emphasizes individual self-determination and places little emphasis on obedience. Advancing this line of thought, we aim to examine whether India's cultural values in some way facilitate crony capitalism.

The chapter is organized as follows: we first provide a brief description of crony capitalism in India. This is followed by an in-depth discussion of cultural determinants of crony capitalism by focusing on dominant cultural dimensions in India. We then identify the societal processes emanating from cultural dimensions that create conditions for crony capitalism to develop and propagate.

Crony capitalism in India

Crony capitalism refers to a political-economic system in which success of a business is dependent on maintaining close relationships with the state (Holcombe, 2013; Kang, 2002). Such relationships create an uneven distribution of resources, providing benefits to well-connected, usually big and elite businesses (Ip, 2008). Although special relationships between businessmen and political elites can be found in almost every capitalist regime, they tend to be more pervasive in certain societies. In particular, India's economic history is riddled with examples of crony capitalism from the socialist era to today's neoliberal reform policies.

A *sine qua non* of a successful business in India is to be cronies of political leaders (Khatri, 2013). Due to the lack of a proper institutional framework, special relationships with political leaders provide businesses an advantage over competitors. Through these relationships, some businesses get special treatments and exemption from rules. The importance of cronyism in sustaining business is part of the general psychology of Indian businessmen (small or big). Therefore, it would not be an overstatement to say that cronyism is a dominant business ethos in India (Kamath, 2012; Khatri, 2013).

We conceptualize India's form of crony capitalism as a close relationship between businessmen and political leaders based on a mutual interdependence to achieve long-term benefits for both parties. The purpose of these interdependent relationships is obvious: politicians need money to fund their political ambitions which businesses are eager to provide in exchange for special favors (Gowda & Sharalaya, Chapter 7 in this book). Due to lack of laws and regulations, black money freely flows in Indian elections. In fact, in India, only 20% of the sources of funding to political parties are known (Quraishi, 2014). As businesses offer cash in return for favors and special contracts, the free market forces that impart vibrancy to an economy get crippled resulting in various dysfunctional effects.

India's crony capitalism is characterized by a patron-client relationship based on mutual trust and obligation. The relationships between businesses and statesmen are often intimate and based on hierarchy and long-term goals (Ip, 2008). A political elite may grant a special favor to a particular business without any immediate reward but based on an understanding that this favor will be returned in future. These relationships endure because of this reciprocity (Aligica & Tarko, 2014).

Cultural determinants of crony capitalism

Culture refers to a system of attitudes, values, beliefs, symbols, and assumptions shared by the members of a society (Hofstede, 1994). In explaining the importance of culture, Kluckhohn (1954) provides the following analogy, 'Culture is to society what memory is to individuals'. This analogy emphasizes the importance of culture in influencing and guiding social behavior (Parsons & Shils, 1990; Steidlmeier, 1999). The pervasiveness of culture in all aspects of life makes it plausible to argue that certain cultural values when present in a society will foster cronyism (Khatri et al., 2006). Williamson (2002) concurs and views culture as the 'most fundamental force' behind human motivations in the marketplace. In other words, cultural norms may have greater influence on human behavior than formal laws and rules in many societies such as India.

In understanding the role of cultural determinants of crony capitalism, we focus our attention on the following dimensions: (1) individualism-collectivism, (2) achievement-ascription, (3) verticalness-horizontalness, and (4) universalism-particularism.

Individualism versus collectivism

One of the most distinct manners in which one society differs from the others is how its members relate to one another, referred to as individualism versus collectivism in modern literature. The individualism-collectivism cultural dimension describes the relationship of an individual with the group (Hofstede, 1980, 1994). Individualism as a dominant cultural value exists in those societies in which the relations between individuals are loose. In contrast, collectivism as a cultural orientation exists in those societies in which people have strong ties. In such societies, cohesive in-groups are dominant and strong norms exist for individuals to strictly conform. These in-groups provide support for individuals in exchange for unquestioned loyalty (Hofstede, 2001).

Schwartz (1992) advances the notion of individualism and collectivism by placing it in a taxonomy of values. Schwartz differentiates cultures along the embeddedness-autonomy dimension. Like the individualism-collectivism dimension, this dimension focuses on the degree to which individuals are autonomous (independent) or embedded (dependent) into the group to which they belong. In autonomous cultures, an individual acts independent of others and uniqueness is emphasized. However, the embeddedness emphasizes the group and encourages status quo and solidarity.

India's societal culture emphasizes a collectivistic orientation where self is defined interdependently with others, goals are compatible with in-group goals and emphasis is placed on norms, obligations and duties. Focus on interpersonal relationships based on familial ties, friendships, and other bonds create moral obligation in collective and embedded cultures (Chen et al., 2002) and it is fairly common for individuals in these societies to break rules and legal procedures to fulfill these obligations (LaPalombara, 1994; Seleim & Bontis, 2009). In fact, in collectivistic cultures like India, interpersonal relationships are the basis of moral and legal compliance rather than formal structures (Weaver, 2001). Consequently, loyalty, trust, and mutual obligations are governing values in transactions. Since business practices often emulate societal values (Hofstede et al., 2010), it is not surprising that such values are also ingrained in the Indian business psyche. As a result, businesses often maintain or strive to maintain close relationships with people in power in order to receive special favors. Since this relationship is characterized by loyalty and mutual obligations, businesses develop long-term relationships with politicians by doing favors, such as making party fund contributions. What initially starts as a transaction to support political campaigns eventually transforms into ways for accumulating personal wealth.

Ascription versus achievement

The second cultural dimension having bearing upon crony capitalism in Indian context is Trompenaar's dimension of achievement versus ascription. This dimension refers to how status is accorded in a society. In achievement-focused societies, one's status is determined based on earned achievements of individuals; whereas in ascription-oriented cultures, status is accorded based on inherent characteristics such as family, gender, or age (Trompenaar, 1993). In other words, in societies that emphasize ascription the status is not earned but is ascribed to the individual. As a result, one's affiliations are strong determinants of one's success in ascriptive societies. Consequently, people in such societies extensively use their titles and affiliations in business transactions as well.

Indian society has long been divided along caste and religion. Hence, there is a tendency to determine one's status based on birth. Certain jobs and roles were, and in some cases still are, determined based on the caste to which one belongs. This cultural tendency to associate one's status solely based on one's familial ties makes Indian society fraught with nepotism. For example, the Congress Party's determination of party leader has been based on familial ties for decades. Instances of ascription are quite prevalent in the corporate world as well. Take, for example, the recent news about Reliance Industries inducting 22-year-old Akash and Isha Ambani (twin children of Chairman Mukesh Ambani) onto the Board of Directors of Reliance Jio Infocomm and Reliance Retail Ventures, the company's telecom and retail units.

The high value placed on ascription combined with collectivism make nepotism and cronyism acceptable ways of doing business in India. Since the moral compass justifies using one's affiliation over achievement, many in India might not view cronyism as immoral. Consequently, it is not surprising that when a political leader provides a particular business (usually from his in-group) with a favorable outcome at the expense of another business (usually more deserving), there is not much uproar. Take, for example, the coal allocation scam. The ruling party in India at the time, the United Progressive Alliance, chose not to auction coal blocks using competitive bids from 2004 to 2009. Rather, some 25 companies including Essar Power and Jindal Steel and Power were handed out coal blocks based on nomination (*India Today*, 2015). An interesting point to note is that this scam was brought to attention by a complaint filed by the opposition's Bharatiya Janata Party (BJP) and not by public interest groups or activists.

As a result, conducting business transactions based on personal relationships has become a *sine qua non* of doing business in India. It would not be an overstatement to say that cronyism enjoys some amount of legitimacy in India.

Verticalness versus horizontalness

Another distinct way societies differ from each other is how power is distributed in a society. Hofstede advanced this notion along the dimension of power distance (Hofstede, 1980). He defined power distance as the extent to which the less powerful members of institutions and organizations in a country expect and accept that power is unequally distributed (Hofstede, 1980). Similarly, the hierarchy and egalitarianism dimensions in Schwartz's (1999) framework focus on whether or not individuals are treated equal in a given society. In egalitarian cultures, the emphasis is on transcending selfish interests to maintain social equality. Schwartz (1992) contends that egalitarian societies emphasize equality, social justice, freedom, responsibility, and honesty. In hierarchical cultures, on the other hand, emphasis is on achieving personal and group goals even if it comes at the expense of others.

Triandis (1995) combined the cultural dimension of power distance with individualism-collectivism and offered four cultural syndromes: vertical individualism, vertical collectivism, horizontal individualism, and horizontal collectivism. The vertical-horizontal dimension of individualism is similar to the notion of power distance (i.e., the extent to which the less powerful members of institutions and organizations in a country expect and accept that power is unequally distributed) proposed by Hofstede (1980). Vertical societies assume that people are different from each other and hierarchy is a given (Triandis, 1998). In horizontal cultures, equality is the norm and being different from others is shunned.

The vertical-horizontal dimension has provided important insights in understanding corruption. The most corrupt countries on the Transparency International Corruption Index tend to be vertical collectivistic (Li et al., 2006). In a study on culture and corruption, Triandis and colleagues found that vertical collectivism was strongly related to deception (Li et al., 2006).

In examining the use of power by individuals, Shavitt et al. (2010) argue that vertical individualists tend to use power in very personalized way (i.e., for self-advancement) whereas horizontal collectivists use power in a socialized way (i.e., for helping others). In contrast, the use of power for vertical collectivists tends to be context-specific (Shavitt et al., 2010). Vertical collectivists may use power in a personalized way when dealing with an out-group, yet use power in a social manner when dealing with their in-group members and use it for well-being of their in-group. In other words, when dealing with out-groups, vertical collectivists may use their power for the hostile treatment and prejudice of out-groups (Triandis, 1995), while simultaneously using power to advance the interests of their in-groups. Therefore, in a vertical collectivistic culture like India, it is common for people in power to give preferential treatments to their in-group at the expense of the out-groups. The combined effect of high levels of collectivism and hierarchy in India means that people in power use their discretionary power to advance the interests of their in-groups. Since favoritism is an accepted norm in India's collective culture, the general populace does not show as much outrage with government-business transactions marked by favors and exceptions as in a more horizontal society such as Denmark.

The vertical-horizontal dimension also influences whether or not decisions made by those in authority are subject to scrutiny. In horizontal cultures, individuals do not easily yield to authority and people often raise their voice against favoritism to maintain equality (Khatri et al., 2006). In contrast, the power dynamics in vertical cultures place more emphasis on conformity and submission to authority. In a cross-national analysis involving seven countries, Kemmelmeier and colleagues (2003) found that both vertical individualism and collectivism were correlated to authoritarianism (conceptualized as submission to authority and authoritarian aggression) but not horizontal collectivism. As a result, in vertical individualistic and collectivistic cultures, the probability of a deprived party voicing a grievance against someone in authority is low. The effects of these power dynamics are further exacerbated in collectivistic contexts due to the high emphasis on harmony. In these cultures, if someone does report a grievance about preferential treatments given to certain individuals, he or she might be viewed as a traitor and might face severe consequences for engaging in such a behavior (Zheng et al., 2013). As a result, in vertical collectivistic cultures, it is likely that those in power will not be subjected to much scrutiny when they use their power to grant favors to their personal connections thus making it easier to abuse their power. These norms governing the use of power and deference to authority to maintain harmonious relationships means that certain individuals will abuse their power to grant favors to their personal connections without penalty.

The uneven distribution of power is perceived as quite legitimate in India's societal context. As a result, elites enjoy a privileged status and are not usually held accountable for their actions. People in power, both in business and in politics, escape the scrutiny that others have to face when they do not follow the regulations. This negatively influences businesses that lack political protection and discourages young entrepreneurs from entering into the market even though they might be well equipped with skills and assets. Due to the high emphasis placed on in-group cohesion, respect for in-group norms (due to collective orientation) and status differences, cronyism is more likely to occur in vertical collectivistic cultures than in other cultures (Khatri et al., 2006).

Universalism versus particularism (or rules versus relationships)

Based on Parsons and Shils' (1951) work, Trompenaar (1993) differentiated societies based on what matters more: rules or relationships? This dimension focuses on how behavior is judged in a given society: whether a universal set of rules always applies (universalism) or if behavior should be dealt with on an individual basis (particularism). In universalistic societies laws and regulations are applied equally to everyone whereas in particularistic societies laws and regulations are applied flexibly and individual situations determine how the rules are applied. This dimension has an intuitive appeal for better understanding cronyism because it focuses on how behavior is evaluated in societies.

In particularistic cultures, the unique aspect of the situation and the relationship between the actors involved in the situation guide a person's decision-making. On the contrary, in universalistic cultures, business practices emphasize detailed contracts that are applied equally to everyone, regardless of what group one belongs to. Given the collective nature of India's societal context, one's in-group needs often serve as the basis for determining how the rules are applied. In particularistic cultures, it is fairly common to make exceptions for one's in-group based on familial ties, kinship, and/or friendships (Tompkins et al., 2010). As a result, in particularistic societies like India, contracts are not deemed important in conducting business transactions. Rather, it is fairly common to change business contracts or change terms and conditions to accommodate one's in-group's needs. Take, for example, the recent 2G scandal in India: the rules of allocation for 2G spectrum licenses were changed mid-course by the then telecom minister of India in order to favor a few chosen businesses at the expense of others (*Times of India*, 2011).

Cultural particularism has important implications for the legal and justice system. Particularism directly affects whether strict laws and regulations can be applied with ease or not. Laver (2014) contends that governance norms that fail to match the cultural environment do not get a strong footing in a society. Enforcement of formal rules and regulations aimed to achieve fairness are likely to clash with informal norms that support favoritism. In light of this, it is not surprising that India does not a have a reliable judicial system (Khatri, 2013). Furthermore, particularism also affects how comfortable people feel while breaking laws. It is quite acceptable to bend or break the law to help someone in difficulty in particularistic societies (Trompenaar, 1993). In fact, laws and justice are interpreted in a loose manner by the general populace of India. Consequently, the degree of compliance with laws is low. Unsurprisingly, certain illegal behaviors that are shunned in universalistic countries enjoy cultural legitimacy in India.

Further, it is fairly common in particularistic contexts for government officials to grant special favors or exceptions to their allies. Businesses which are not allies of government officials also strive to create connections with government officials to receive special favors. All these norms governing behavior in the particularistic context of India create a breeding ground for crony activities.

Based on the above discussion, we contend that some dominant cultural values in India lead to certain processes that facilitate crony capitalism. Specifically, cultural values of India encourage inequality of influence, disregard of law, and poor enforcement of rules and regulations aimed at preserving fairness. Together, these processes create conditions for crony capitalism to develop and propagate (See Figure 6.1). We discuss these processes below.

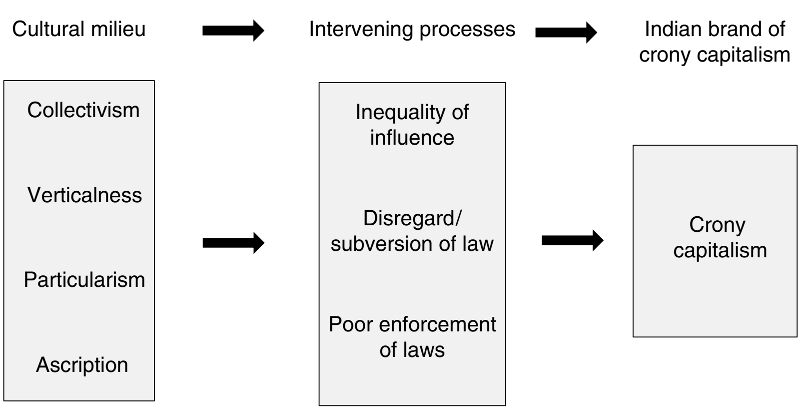

Figure 6.1 Cultural determinants of crony capitalism in India

Indian cultural milieu and crony capitalism: intervening processes

Inequality of influence

The greater emphasis placed on ascription, collectivism, and power distance in Indian culture makes inequality a fact of life. In a stratified and paternalistic society like India's, decisions are made based on personal relationships rather than merit. People in power are likely to use their power to grant favors based on favoritism and loyalty rather than on merit and right. Due to the unequal distribution of power and close-knit groups in India, power tends to be concentrated among few, making them 'elite'. These elites and their in-groups have special privileges that are not accessible to the majority of the populace. The 'elite' can use their resources (in terms of both power and relationships) to manipulate and subvert institutional processes to protect and enhance their privileged positions. This creates an inequality of influence via inefficient redistributions, anti-competitive measures and other discriminatory practices (Hellman & Kaufmann, 2003) that perpetuate crony capitalism.

Disregard or subversion of law

The embedded and particularistic emphases placed in India lead to a very loose interpretation of law in India. Due to vertical orientation, people holding higher positions can behave unethically and get away with it. As a result, the powerful feel as though they have a right to subvert legal processes or manipulate these processes to their advantage. The less powerful individuals or groups do not perceive legal processes to be impartial (Hellman & Kaufmann, 2003). In fact, as discussed earlier, people in particularistic countries quite easily accept skewed institutional processes that favor the privileged or elite. Since perception and behavior are mutually reinforcing, the privileged groups continue to mold institutional processes to benefit themselves or their in-groups.

Poor enforcement of rules and regulations

Particularistic tendencies in India also impact enforcement of laws in India. It is quite difficult to implement regulations and laws that do not match with the cultural environment of a particular country (Laver, 2014). The regulations and laws aimed at promoting fairness and impartiality are not likely to get a strong footing in India's cultural contexts that promote favoritism and nepotism.

The subversion of laws and regulations and the poor enforcement of laws further accentuate inequality of influence and promote crony capitalism (Aligica & Tarko, 2014).

Paradigm shift in Indian political and cultural spheres

The results of the 2014 general elections in India reveal the changing mindset of the Indian population. In a historic turn of events, the BJP, led by Narendra Modi, won the elections. The BJP was able to garner votes from different economic and social groups. The historic win of the BJP was attributed to its election campaign that focused on economic development and good governance. In addition, the prime ministerial candidate, Narendra Modi, was widely popular among the masses. His plans to revive the economy by easing regulations related to land, labor, taxes, and subsidies resonated with voters yearning for faster economic growth. Another reason for his popularity may be that people perceived him as 'self-made' and valued his achievements over the ascriptions of other political dynasts.

Interestingly, a few months later, the BJP lost the legislative elections in Delhi to the Aam Aadmi Party (AAP), a new and young political party. The AAP based its election campaign on anti-corruption; the BJP's campaign was anti-AAP. The historic win of AAP over established parties like the BJP and Congress indicate that Indian society wants its government to be progressive. Indian voters can no longer be manipulated along caste and religious lines. Rather, the message of the Indian populace is loud and clear: they want their government to curb corruption, facilitate economic growth and move toward a market-based economy.

Like the political landscape, shifts are occurring in India's cultural contexts too. India's participation in the global economy has given many individuals, both from urban and rural areas, a foothold in today's global economy. At the societal level, India's participation in the global economy is enabling some changes at societal level as well, such as smaller households and delayed marriages (Newson et al., 2005). At the individual level, these social changes are triggering a change in how individuals think and behave. For example, Indian youth today are not as influenced by traditional sources of social influence as their parents or grandparents were. The youth have more freedom in decisions like how to spend their money, when and whom to marry and when to have children. One's in-group or kin conventionally made these decisions. These shifts in psychological and social processes are empowering individual thought and facilitating autonomous decision-making leading to the rise of individualism in India. In addition, the increasing numbers of diaspora returnees act as transcultural ambassadors who further instill the values of independence and equality.

The amalgamation of maturing democracy, shifting cultural values and the proliferation of technology are acting as catalysts for change in India's outlook. India is transitioning to a society that values meritocracy over aristocracy (Mazumdar, 2014). With the changing social forces, it is likely that institutional changes will facilitate transparency and economic freedom. These new paradigms provide a solid foundation for a truly individualist and capitalist ethos to evolve and flourish.

Conclusion

Cultural values shape all aspects of life. A high emphasis on in-group favoritism, respect for authority and deference to power results in people making decisions that favor cronyism and ignore merit. Furthermore, the particularistic tendencies in India affect governance norms, making it hard to implement processes that are just and fair. We argue that the cultural context of India facilitates inequality of influence by allowing certain powerful groups to have more control over resources as well as a disproportionate allocation of resources. This uneven distribution of resources and power is further intensified by the cultural norms that lead to disregard for and poor enforcement of laws.

We see a clear association between the above-identified processes and India's currently low rankings on several business indices. Based on our cultural analysis of India, we believe that the changes are needed to bridge the gap between Indian social classes, eliminate corruption and crony capitalism and move India toward becoming the economic powerhouse many predict it could be. India needs to go beyond its current model of society and politics. It is evident that deep cultural norms will need to be replaced with new ideals. As suggested by Khatri and Ojha in Chapter 4 of this book, crony capitalism in India is not an isolated problem. It is a reflection of all the facets of Indian society. To curb cronyism, they suggest that Indian society will have to foster the doctrine of ethical universalism in public life consisting of three key features: (1) participation in public affairs, (2) public office not as privilege but civic duty, and (3) everyone if equal before the law. In addition, they recommend inculcating a liberal ethos in Indian society, preserving freedom of speech and press, and separating the domains of economics and politics. Only time will tell if the younger generations will have enough power to facilitate such a cultural shift.

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7
Crony Capitalism and India's Political System[1,2]

M. V. Rajeev Gowda and *Nandan Sharalaya*

Introduction

The following quote by Raghuram Rajan (2014), governor of the Reserve Bank of India, captures the main thesis of this chapter and the connection between politics and crony capitalism in the Indian context:

> The crooked politician needs the businessman to provide the funds that allow him to supply patronage to the poor and fight elections. The corrupt businessman needs the crooked politician to get public resources and contracts cheaply. And the politician needs the votes of the poor and the underprivileged. Every constituency is tied to the other in a cycle of dependence, which ensures that the status quo prevails.

Crony capitalism is a system under which business profitability hinges considerably on the ability to maintain strong relationships with bureaucrats and politicians. Money typically lubricates these relationships. The incentive for businessmen to invest in relational capital is that bureaucrats and politicians may be in a position to grant specific regulatory favors or monetizable benefits that give them a competitive edge over others. Since governments the world over exercise regulatory functions, taxing authority, allocation of subsidies and transfer payments, Tullock (1967) argues that the business class in general will always have an incentive to devote resources to go about acquiring favorable treatment, triggering corruption and crony capitalism.

India has featured prominently in several international cronyism indexes over the years. In this chapter we argue that crony capitalism in India is driven substantially by the demand from the political class for finances to run election campaigns and the supply of finances from the corporate sector in exchange for preferential actions from the government. This symbiotic relationship has had far-reaching fallouts. Beyond distortion of competition, it has led to the institutionalization and decentralization of corruption, predatory and inefficient governance, criminalization of politics and a decline in societal values overall.

In this chapter we describe the evolution of crony capitalism in India and its *modus operandi*. In Section II, we discuss the costs of elections by focusing on the 2014 general election. In Section III, we contrast media and other estimates of election spending with that reported by political parties. We discuss why this difference arises and what it implies. In Section IV, we discuss the evolution of crony capitalism in India and explore the origin and growth of crony capitalism in India. In Section V, we discuss the challenges of pinpointing crony capitalism. In Section VI, we explore the nature of India's lobbies, specifically the liquor and infrastructure lobbies and their nexus with politics. In Section VII, we discuss the changing contours of the businessman–politician relationship in India. In Section VIII, we highlight how various institutions including courts and civil society have acted as a check on runaway corruption. In the concluding Section IX, we discuss alternative, legitimate ways of funding political parties and elections that would make it possible for India to break out of the crony capitalism trap.

The costs of Indian elections

The 2014 general election to the lower house of India's parliament, the Lok Sabha, saw the participation of close to 714 million Indians in the world's largest democratic exercise (Election Commission of India, 2014). An estimate by the Centre for Media Studies pegs the total campaign cost incurred by political parties at $4.9 billion, which is ten times the $552 million it cost the government to conduct the polls (Gottipati & Singh, 2014). *The Indian Express* reports that between 2009 and 2014, the advertising campaign budget of political parties alone tripled from $83 million to $300 million (Ghosh, 2014). With increasing advertising, event management and transportation costs, parties have to ensure that they have the funds available to stay competitive. Commenting on the Bharatiya Janata Party's (BJP) victory, India's former finance minister P. Chidambaram of the Indian National Congress (INC, also known as the Congress party), stated: "Never before did India's election to the Lok Sabha witness such a masterly combination of organisation, money and technology" (Chidambaram, 2014).

With star campaigners jet-setting the entire length and breadth of the country on a daily basis, just the cost of transportation was astronomical during this election. Aviation experts estimate the cost of flying in a single-engine helicopter at around $1000–$1300 per hour while in the case of a twin-engine helicopter, the cost goes up to $1500–$1700 per hour. For Learjets, the flying cost per hour is around $4500–$5,000 per hour. The BJP's prime ministerial candidate, now prime minister, Narendra Modi, alone flew to over 150 rallies across the country, clocking 240,000 km, or an average of about 1,100 km a day (Mishra and Kaushik, 2014).

To illustrate the scale of electoral campaign expenses, we can consider what the BJP spent on its campaign and assume that other national parties' expenditures are in the same ballpark. Each public rally would have cost anywhere between $800,000–$3 million (*Hindustan Times*, 2014). The major expense would have been hiring giant 30-feet LED screens, running 10 to 15 special trains, 4,000 to 6,000 buses and a fleet of private cars to mobilize and transport party workers and supporters, hiring waterproof tents and making food and lodging arrangements. The BJP's campaign would have cost $8 million more where it used expensive 3D hologram technology to relay Modi's speeches at rallies where he could not be present physically (Jain & Thakur, 2015).

The BJP also booked 15,000 billboards at a cost of Rs. 25 billion for up to three months with cost ranging from $3,000–$4,500 per billboard per month in cheaper locations to as much as $30,000 per billboard per month in Mumbai's Nariman Point (*Economic Times*, 2014). For print advertising, the BJP bought the most prominent ad slots across national, regional and vernacular newspapers for forty days at a budget of approximately $80 million with an additional amount allocated to magazine advertising. On television, the BJP bought close to 2,000 spots a day across Hindi, English and regional news, general entertainment and sports channels at a budget of $125 million (Gurtoo, 2014).

However, it is not only national elections that cost astronomical amounts. Journalist Sreenivasan Jain's interviews during the Maharashtra state assembly elections in 2014 revealed that candidates expected to spend anywhere from $300,000 to $600,000 per assembly seat. Even at an average of $300,000 per seat, that works out to approximately $500 million expended by the four major competing parties (Jain, 2014). Crucially, this number pertains only to candidate expenses and not those incurred by the political parties, for example, costs incurred for the travel and rallies of central leaders/party star campaigners, advertising campaigns, and so on, for which there is no expenditure cap under

Indian election laws. From this, it can be inferred that $600 million worth of cash was pumped into a single Indian state in the course of just two weeks.

Clearly, India's elections cost an extraordinary amount. When one considers that elections are held, typically, at five-year intervals, for representative positions from the village to the block to the district to the legislative assembly and to parliament, we have a scale of election expenditure that is truly astronomical. The roots of crony capitalism lie in the necessity for candidates and parties to raise the funds required to stay competitive in this elaborate electoral landscape. But before we explore that aspect, it is worth exploring another feature of India's elections – massive underreporting of election expenses, which has its own relationship to crony capitalism.

The puzzle of reported costs versus actual costs of elections

No reliable estimates of the actual electoral expenditures incurred by parties and candidates yet exist. Researchers can partly infer the magnitude by studying media coverage of campaigns. The rallies addressed by some star campaigners receive publicity; multiplying the number of such rallies by a reasonable estimate of the cost of a rally would yield one component of overall election expenditures. Further, reports in industry-specific media may yield clues; for example, which agency won an advertising contract and for what amount. Based on such information, the Centre for Media Studies pegs total spending in the 2014 general election at a mammoth Rs. 30,000 crore ($5 billion), a sum second only to the Rs. 42,000 crore ($7 billion) spent during the 2012 US presidential race, the world's most expensive (Singh, 2014) election campaign.

For earlier polls, only one scientific study of election expenses exists: the Centre for the Study of Developing Societies' National Election Audit 1999 (NEA, 99). This field study of 24 sample constituencies revealed that "fifteen candidates who polled 3.5 to 16.5 percent votes spent an average of Rs. 3.5–6 million (then $87,500–$150,000). The 50 candidates who polled over 16.5 percent votes, spent on an average Rs. 7.355 million (then $184,000)." This figure includes candidate, party and independent supporter expenditures. This data clearly suggests that to be competitive, candidates need to spend a certain minimum amount. However, above a certain threshold, spending alone does not correlate with vote shares. . . . "[Further], the spending gap between winners and runners-up was not all that large" (Gowda and Sridharan, 2012).

In terms of party expenditures in 2014, media estimates peg the BJP's actual expenditure at a mammoth $780 million. However, in its official filing to the Election Commission of India (ECI), the BJP reported that it spent $110 million. Similarly, the Congress, in its official filing, claimed to have spent $80 million. When compared to media estimates, these official expenditure amounts declared by political parties appear to significantly understate costs. This mismatch between declared and actual expenditure is a clue to a key feature in the structure of crony capitalism in India.

It is puzzling that parties may be understating expenditures because, unlike individual candidates, they do not face any regulatory ceiling on how much they can spend. Parties are also exempt from income taxes (subject to certain conditions) so they lose nothing by demonstrating a healthy balance sheet. However, parties may only report enough contributions to cover their official expenses. Otherwise they underreport their earnings for the following reasons.

First, parties do not have an incentive to report their actual expenditures as this would entail closer scrutiny and they would have to account for the sources of their funds. This poses a difficulty if parties receive funds in cash, which may possibly be unaccountable or black money. Parties typically exploit a regulatory loophole to convert cash into official funds. Regulations mandate that parties need to declare the sources of funds only when contributions exceed the threshold of $310 or Rs. 20,000. Hence, if a party was looking to raise $1,550 or Rs. 100,000 in unaccountable cash, it could choose to accept five installments of Rs. 19,999 from the same source without making public the names and details of donors.

An Association for Democratic Reforms (ADR) analysis (ADR, 2014) of parties' income tax returns showed that between 2005 and 2013, the six national political parties (Congress, BJP, Bahujan Samaj Party, Nationalist Congress Party, Communist Party of India (Marxist) and Communist Party of India) declared a total income of $940 million (Rs. 59.86 billion). Out of this, $690 million (Rs. 43.65 billion) or 72.98 per cent was from "unknown" sources, that is, donations below Rs. 20,000. Moreover, corporate and business houses contributed 87 per cent of the total donations received by national parties between 2004–2005 and 2011–2012 (ADR, 2014). Given the magnitude of such donations, organizations like ADR demand that parties declare the sources of all funds received. However, this would be cumbersome for parties as they are hardly organized in a "corporate" manner with an army of accountants. Further, people do get "election fever" and voluntarily contribute cash, time and material resources during campaigns; party mechanisms are typically not robust enough to track all such donations formally.

Second, parties may not want to disclose the scale of their fundraising and expenditures because some portion of these funds may be used to provide various illegal inducements and bribes to voters. For instance, midway through the election cycle, until April 15, 2014, the Election Commission of India (ECI) had seized over Rs. 217 crore in cash all over the country (Singh, 2014). Of this, Rs. 118 crore was seized in Andhra Pradesh alone, followed by Rs. 18.31 crore in Tamil Nadu, Rs. 14.40 crore in Maharashtra, Rs. 10.46 crore in Uttar Pradesh and over Rs. 4 crore in Punjab including numerous other small seizures in the rest of the states. In addition to cash, 10 million liters of liquor and 100 kg of heroin (mostly in Punjab) have been seized (Singh, 2014). Once parties go down this path of offering money in exchange for votes, given India's population, they will find themselves in the electoral equivalent of an out-of-control arms race.

Some parties moderate such expenditures by instead promising state-funded freebies if and when voted to power. In Tamil Nadu, instead of the government funding public goods like roads and infrastructure, parties regularly promise and then provide private goods to voters post-elections. Cycles, laptops, television sets, mixer-grinders, and rice cookers have all been doled out by the government. The funds come out of the state exchequer thereby creating a rampant freebie culture.

Third, parties also partially fund their candidates by providing them with cash and publicity material. Typically, candidates take care of the logistics of organizing rallies for star campaigners in their constituencies. They also need funds for various other campaign expenditures. However, the regulatory framework imposes strict limits on how much an individual candidate can spend on an election (recently revised upward to $110,000 or Rs. 70 lakhs per parliament constituency, comprising of around 1–2 million voters). These limits were originally intended to create a level playing field so that even less economically well-off candidates could contest elections but have instead led to perverse outcomes with far-reaching consequences.

Fundamentally, because candidates cannot openly spend above the low expenditure limits, they prefer not to raise money through checks or other open contributions legally. If they were to spend these funds openly, they would be disqualified and lose their seats. Instead they prefer to use cash or unaccountable money for election expenses. This demand for cash is one of the triggers of crony capitalism and predatory governance. Confronting and fixing such counterproductive legal rules will possibly remove this trigger and set the polity on a more positive trajectory.

Evolution of crony capitalism in India

India's tryst with cronyism dates back to the days of the license-permit raj, from the 1950s till economic liberalization in 1991 (see Khatri & Ojha, Chapter 4 in this book). The government maintained tight control on the private sector and dictated what industry could produce and on what scale. The motivation for this intrusive government role was that resources were scarce in newly independent India. Hence it was felt that their allocation should be guided by considerations of public policy rather than private profit. This policy framework had been developed in consultation with industry (the Bombay Plan) and was idealistic in its conception. However, it had counterproductive effects. Industrialists realized that obtaining a license was sufficient to ensure a near-monopoly position in India's shortage-driven economy. They therefore chose to compete in the corridors of power to obtain licenses and favorable interpretation of rules (see Khatri & Ojha, Chapter 4 of this book). Inducements, including political contributions, were used to grease the wheels of the government's decision-making apparatus. Thus was born crony capitalism (or crony socialism as termed by Dhume, 2011), a cozy nexus between select industrialists, bureaucrats, and politicians.

As Krueger (1974) explains, during that period the brightest Indians were simply not engaged in productive activities that could have added value to the Indian economy. On the contrary, they were engaged in negotiating the quagmire of government regulations to ensure that their firms profited while restrictions were placed on their competitors. In economic parlance, this is referred to as rent-seeking. Government policies and programs once established facilitate the creation of new vested interests who engage in rent-seeking to keep these programs in place. Rent-seeking diverts resources away from productive activity. It facilitates the creation of an inefficient, wasteful, and monopolistic economic environment powered by perverse political and private incentives not aligned with social objectives.

The favors that cronies seek from the government may include protection from foreign competition through tariffs and quotas or from domestic competition through monopolistic regulations that effectively thwart the emergence of an industry rival. Stigler's "capture theory of regulation" (1971) explains this phenomenon. Stigler argues that while the purpose of regulation may be in the public interest, once established, the regulatory apparatus tends to be captured by the industries it was established to regulate. Rampant rent-seeking undermines existing institutional capacity in the government and weakens checks and balances.

Bhagwati (1982) terms crony capitalism as “directly unproductive profit seeking activities” and identifies it as a major reason behind mismanagement and negligence becoming firmly entrenched and deep-rooted in the political ecosystem of India. The deleterious impact on the government is captured by Lant Pritchett (2009) who explains that India has become a “flailing state,” incapable of implementing programs and policies. It is: “a nation state in which the head, that is elite institutions at the national (and in some states) level remain sound and functional but that this head is no longer reliably connected via nerves and sinews to its own limbs . . .” Job postings are often sold, corruption is endemic and there is substantial leakage of government resources. More importantly, there is a net decline in the overall value system and everything is for sale if the amount is right.

Challenge of pinpointing crony capitalism in the Indian context

It is difficult to demonstrate the detailed workings of crony capitalism in the Indian context. Showing the nexus between the business, bureaucratic, and political classes is easier theorized about than proved. One opportunity to provide evidence of crony capitalism arose when the Indian tax authorities tapped the phone of an influential lobbyist, Niira Radia. Their intent was to uncover evidence of tax evasion but they inadvertently stumbled upon conversations between her and India’s leading industrialists, ministers, journalists, and so on. These conversations revealed efforts to influence decisions from cabinet appointments to allocation of land to the family of a key industry association head (Thakurta & Reddy, 2010). However, corruption charges even in this celebrated case were not proven and the Central Bureau of Investigation (CBI) has closed the case on grounds of lack of evidence (Chauhan, 2015).

An award-winning investigative journalist, Sucheta Dalal, has written about an ongoing case that provides a rare peek into the way influence-peddling by crony capitalists actually works in India (Dalal, 2015). This case was filed by the Centre for Public Interest Litigation against the multibillion dollar Essar Group. The evidence submitted includes internal emails leaked by a whistle blower which show that secret details of the Union Budget were available to Essar and that it was able to influence petroleum ministry pricing and policy decisions (Dalal, 2015).

Dalal alleges that the "group has enormous funds earmarked to buy these favours."

Dalal (2015) describes what she claims to be the company's strategy of ripping off banks and institutions and diverting funds to finance its growth. She points out:

> In 1999, the chairman of Bank of India (BOI) sanctioned a fat bailout to a group company on the eve of his retirement. Two months later, he joined the group as an advisor at a fee that was a multiple of his last salary. . . . Soon, every other institution fell in line and wrote off several thousand crores of rupees worth of loans and overdue interest to several group companies. . . . That Essar's outstandings can wreck the profits of major banks ensures that they are again working at 'restructuring' its loans with tacit support from the government. This is a sordid story of crony capitalism, first leeching off public shareholders and then public sector banks.

Dalal (2015) also points to the 2013 report of the Comptroller and Auditor General of India (CAG) on public sector undertakings which lists the numerous occasions when officials of the Gujarat-government-owned Gujarat Petronet favored the group and passed on undue benefits running into over $100 million collectively to group companies Essar Steel and Essar Power, Gujarat.

Dalal alleges that the group tried to intimidate her with criminal defamation cases and that in other instances has sponsored an "ideas festival" for a magazine in exchange for suppressing a story against the group. She argues that this carrot and stick policy has worked well for decades of its dealing with bankers, bureaucrats, journalists and politicians. She concludes that "[t]he Essar diaries, and leaks, pertain only to a small recent phase, but provide an insight into how this well-oiled system of influence has worked for the past 30 years" (Dalal, 2015). However, we must point out that these are all allegations and the case is still ongoing. The court's eventual verdict will determine whether the evidence discussed by Dalal (2015) withstands the test of judicial scrutiny.

The larger question remains: how do we identify crony capitalism in specific instances? Further, how much do governmental favors to a specific corporate group constitute crony capitalism and how much do they constitute industrial policy? We examine three case studies: (1) The Adani Group; (2) The Tata Group's move to Sanand; and (3) Prime Minister Manmohan Singh, the Birla Group and Coal Allocation. Our aim is to explore whether government intervention can necessarily be painted with the brush of crony capitalism or can be justified as proactive measures in the larger interest of the state and the economy. We have chosen these cases because these industrial groups have made substantial and open political contributions to political parties.

Questions about the Adani Group

The Adani group is an industrial house based out of Gujarat and now has substantial presence across India and abroad. It is active in the infrastructure, natural resources and power sectors, and increasingly, defense production, where governments still have a critical role to play, for example, lowering costs by providing land at concessional rates. Headed by Gautam Adani, it has grown exponentially from 2002 with the bulk of its growth funded by banks. Adani is reputedly close to Narendra Modi, India's current prime minister, who served as chief minister of Gujarat from 2002 to 2014. In 2002, Adani Enterprises' assets stood at \$375 million with a market capitalization of \$73 million. By 2013, its assets had risen more than 50 times to \$20.6 billion with a market value of about \$7.8 billion (Mehrotra, 2014).

The Adani Group has also gained substantially because of an increase in its stock market valuation. A year after the general election, Gautam Adani's net worth has shot up 48 percent to an estimated \$8.1 billion, the highest wealth gain among India's billionaires (Sasi, 2015). Interestingly, the stock price was rising even before the general election result suggesting that markets expected that Modi would win and the Adani Group would do well under a Modi regime. The spike in the company's valuation is, however, not justified by any apparent improvement in its finances. The company suffers from a cash flow mismatch due to a mix of ambitious capital expenditure commitments and losses at Adani Power (Kant and Chatterjee, 2014).

The Adani Group has recently been granted 148.59 hectares of forest land in Gondia district in the Vidarbha region of Maharashtra state to be "diverted" for the construction of a 1980 megawatt (MW) coal-based thermal power plant. The tract was identified for the project by the Ahmedabad-based conglomerate in 2008 but final permissions were granted only in August 2014 after the Modi government took office.

Gautam Adani accompanies Prime Minister Modi on most of his foreign trips and conducts business meetings on the sidelines of the official visits. Most visibly, during his high-profile visit to Australia, Modi joined Adani at a meeting with the chairman and leadership team of the Indian government-owned State Bank of India (SBI). This meeting led to SBI agreeing to examine the Adani Group's request for a \$1 billion loan to

Adani Mining, its Australian subsidiary, for the Carmichael coal mine in Queensland, Australia. This loan, if extended, would be one of the largest given out by an Indian bank for a foreign project.

The suspicion of crony capitalism can arise in this case because a number of other international banks had turned down Adani Mining's loan request, questioning both the viability of its coal project as well as its financials, given its existing level of debt. As of September 30, 2014, the long-term debt of the company stood at Rs. 55,364.94 crore (approximately $8.5 billion). The short-term debt stood at Rs. 17,267.43 crore (approximately $2.7 billion). Hence, the total debt of the company stood at Rs. 72,632.37 crore ($11.2 billion), an increase of Rs. 7653.33 crore ($1.2 billion) from March 2014 (Kant and Chatterjee, 2014). However, a counter-argument could be that when a company takes on a higher amount of debt, it gives itself an opportunity to generate higher earnings. Whether or not to lend to such a company is fundamentally a business judgment. If that judgment is colored by the expectation that the company will succeed because of its proximity to the government, then it is still a business judgment but one that considers crony capitalism as a source of competitive advantage.

The Tata Group and Sanand

In 2008, the Tata Group, a leading Indian industrial conglomerate, faced a crucial challenge. Its ambitious plan to establish a car-manufacturing facility in the then communist-ruled state of West Bengal had run into rough weather when it faced violent protests from people whose land was being acquired by the West Bengal government to serve as the factory site. At this critical juncture, the then Gujarat chief minister, Narendra Modi, reached out to Ratan Tata, the group's chairman, and invited him to shift the half-established facility to his state. In addition to land, the Gujarat government offered incentives including a Rs. 9,570 crore loan ($1.5 billion), equivalent to 330 percent of the Tatas' own investment of Rs. 2,900 crore (approximately $450 million) (Pathak and Sathe, 2014). The loan was to be repaid over a 20 year period at a 0.1 per cent interest rate.

The Gujarat government provided the Tatas almost 100 acres of land to set up a township, helped set up a waste disposal plant and supplied natural gas through a pipeline. The price of the land was to be paid for in eight equal, annual installments. The state government also provided four-lane road connectivity and exempted the Tatas from electricity duty, registration and transfer charges of land. With land being provided at concessional rates, tax benefits, soft loans and power at a discount, the Tatas gladly accepted Modi's offer and shifted the factory to Sanand, Gujarat. As per the agreement, the loans would be extended on the condition that Sanand facility ran at full capacity (Pathak, 2014).

The Tata factory was established to produce a "breakthrough" low-cost car, the Nano, priced at $2500 (then Rs. 1 lakh) with the aim of weaning Indians away from two-wheelers. Ultimately, the car was produced and sold in the promised price range (a feat made possible by the massive tax, loan and power concessions from the Gujarat government). However, while the Sanand plant has the installed capacity to manufacture 250,000 cars per year, production remains low as the Nano's sales average just over a 1000 units a month (Pathak, 2014). Even though the state's loans were tied to the Nano plant operating at full capacity, the state government continued to extend its loans. A total of Rs. 419.54 crore (approximately $65 million) of soft loans at 0.1 percent interest rate had been extended to Tata Motors as of January 2015 (*Financial Express*, 2015).

The Tata move to Sanand was followed by other manufacturing majors like Ford, Hitachi and Bosch setting up base in Gujarat. Thus, the question that arises is whether the Gujarat government's substantial subsidies to the Tatas constitutes crony capitalism. Or, given the multiplier impacts on the economy that arise after attracting this high-profile investment, is it really sound industrial policy?

Prime Minister Manmohan Singh, the Birla Group, and coal allocations

In 2013, the CBI initiated a criminal case against the Indian government's top bureaucrat in the Ministry of Coal, Secretary P. C. Parakh. The CBI alleged that Parakh had unduly favored Hindalco, an Aditya Birla Group company, by allocating it part of the Talabira II coal block in Orissa state. The CBI alleged that the application for that coal block by Hindalco had earlier been rejected by the government. A public sector company, Neyveli Lignite, had instead been allocated the block.

However, after the Aditya Birla Group's chairman Kumar Mangalam Birla wrote to the prime minister (who also held the Coal portfolio at that time) and personally met the Coal Secretary, the earlier decision of the governmental steering committee was reversed. A way was found to accommodate Hindalco among those allocated coal from Talabira II. The CBI argued that this raised strong suspicions of criminal conspiracy. Just a few months before the allocation to Hindalco, the government had recommended replacing the existing discretionary allotment system with auctions. Thus this policy reversal raised suspicions of crony capitalism.

Hindalco had earlier been granted a “captive” mine, Talabira I, but the project failed to take off due to several operational issues. This had prompted Secretary Parakh to deny allocation of Talabira II to Hindalco initially. However, after receiving recommendations from the chief minister of Orissa and subsequently reviewing their earlier stance, the Prime Minister’s Office and the Coal Ministry proposed a 30 percent joint venture for Talabira II & III between Neyveli Lignite Corporation and Hindalco, with the remaining 70 per cent allocated to Mahanadi Coal Fields Ltd. In effect, by combining two coal blocks, the government was able to increase the amount of coal available and thus was able to address the needs of Hindalco without significantly affecting the public sector companies, Neyveli Lignite and Mahanadi Coal Fields.

The government had instituted a policy of captive mines designed specifically to ensure private participation in coal mining. Therefore Parakh felt that it was appropriate to accommodate Hindalco while the pooling of coal blocks created a win-win situation for all parties. As journalist Sreenivasan Jain suggests: “Taken at face value, Mr Parakh’s replies suggest the Talabira reversal might be the result of highly unconventional decisions by an independent-minded coal secretary who was willing to bend the government’s own rules if he felt it came in the way of opening up the coal sector” (Jain, 2013). More recently, former CAG Vinod Rai has come out in support of Parakh, arguing that the CBI would eventually give him a clean chit as there was no criminal intent involved on his or the prime minister’s part in the allocation of Talabira II.

The CBI has since filed a closure report stating that it has found no incriminating evidence against the prime minister or the coal secretary. However, the CBI court hearing the case has rejected the closure report. This case study again reveals the suspicion that arises when governmental interventions are painted with a crony capitalism brush. The fact that the industrial house involved in the case contributes openly to multiple political parties during elections fuels the fire. But facts have to be reviewed in each such case to ascertain better whether the government unduly favored a particular corporation or stepped in to initiate proactive measures in the larger interest of the economy.

The symbiotic businessman–politician nexus

As described in Sections II and III, at election time, and in between elections, parties need significant amounts of cash. Cash is used to organize party events, for worker’s transport and daily allowances, for gifts for voters, to incentivize people to attend rallies and public processions, to “purchase” media coverage and to indulge in various other legitimate and undeclared electoral practices. Certain sectors of the Indian economy are both cash-intensive and dependent on the discretionary powers of government for their profits, thus making them suitable for the extraction of political funds. In the section that follows, we discuss how crony capitalism emerges in such sectors, focusing on the case of the liquor and construction industries.

Liquor lobby

The symbiotic relationship between the political class and liquor barons has been a prominent feature of our political ecosystem over the last few decades. The state of Karnataka was famous for being in the grip of the liquor lobby for decades (Karnad, 2012). Part of politicians' dependence on the liquor lobby arises from the need to distribute liquor (surreptitiously) to voters at election time. During the 2014 general elections alone, the Election Commission's law enforcement squad confiscated a colossal 13 million liters of alcohol from the campaign trail (*The Hindu*, 2014). The amount of liquor actually distributed could well be of a much larger magnitude.

Excise duty on liquor production is a significant contributor to most Indian states' revenues. Excise duty is usually levied at the factory gate. But officials and liquor producers can find ways to provide an excise duty paid stamp to some batches of liquor even when it has not been paid. This liquor is then sold at the same market price as the liquor on which excise duty has been levied. The difference is collected in cash and shared between the conniving official and liquor producer. The political class allows this process to continue as long as the liquor producers and officers pass on a share of their ill-gotten earning. Over time, politicians become dependent enough on such funds that liquor barons wield considerable political influence, regardless of which party is in power (Karnad, 2012; Riti, 2004).

The liquor industry has also worked out a lucrative arrangement with state governments over molasses. Almost all the alcohol produced in India uses molasses, a dark, sticky liquid left after sugar has been crystallized from cane juice. Crony capitalism arises because politicians ensure the profitability of liquor barons by keeping this raw material cheap and plentiful. States artificially depress prices by not allowing free interstate movement that would have otherwise led to a unified national market and better price discovery (Srinivas, 2012). In Uttar Pradesh, sugar factories without their own distilleries must compulsorily sell 20 percent of their molasses to liquor companies in the state. Since sugar mills cannot sell the rest of their molasses in the open market until liquor companies have lifted their share, they are forced to offer steep discounts to liquor barons to certify that they have met their regulatory requirements.

As an *Economic Times* report suggests, "when the liquor company obtains molasses for Rs. 600 per tonne instead of Rs. 3,600 per tonne from the open market, the cost of alcohol production drops from Rs. 30 per litre to Rs. 18. This raw alcohol (95 per cent pure) is mixed with a little flavour and diluted with water to make 2.5 litres of potable liquor (40 per cent alcohol content) and then sold at between Rs. 200 and Rs. 1,000 per litre, depending on the brand" (Srinivas, 2012). In recent years, the Rangarajan Committee Report (Rangarajan, 2012) had called for a total decontrol of the India's molasses market. Political parties across the board were united in condemning this recommendation clearly because it would have impaired their relationship with liquor barons.

In a profile of the slain liquor baron Ponty Chadha, Jeelani (2013) describes the other ways in which the liquor industry wields influence and amasses wealth. Jeelani (2013) notes that Chadha was awarded a monopoly over distribution for [Uttar Pradesh] state's Rs. 14,000-crore liquor market. In addition, he was given control of 30 percent of the alcohol retailers across the state and was allowed to purchase a number of distressed but viable state-owned sugar mills at a price below their fair-market value. . . . He eventually held sway over significant parts of the liquor business in Uttar Pradesh, Punjab, Haryana, and Chandigarh, had liquor operations in Rajasthan, Uttarakhand, and Chhattisgarh and amassed a king's ransom through his other enterprises. Chadha's success came from maintaining close ties with the government of the day. Unofficially, his imprint on the government came to be so significant that when liquor was sold at rates above the market price, the extra margin came to be known as the *Ponty Tax* (Jenkins and Malik, 2012).

Liquor barons and politicians also collude to cartelize and artificially manage the alcohol market. For example, in Tamil Nadu (which consumes 17 percent of the total alcohol in the country), an alcohol producer's profits is directly proportional to the relationship that he shares with the government of day (Ravishankar, 2015). In Tamil Nadu, liquor producers owe allegiance to one of the two main parties, that is, All India Anna Dravida Munnetra Kazhagam (AIADMK) or Dravida Munnetra Kazhagam (DMK), that typically replace one another in office at every election. However, an unsaid code of cooperation still seems to exist. During a DMK regime, its associates are favored but the AIADMK's associates are not completely wiped out – vice versa during an AIADMK regime. There are also reports of endemic corruption in the Tamil Nadu State Marketing Corporation, the body mandated to sell and distribute alcohol (Ravishankar, 2015). Some of those proceeds will certainly be ploughed back into the political system.

Infrastructure lobby

Real estate is another cash-intensive sector in India. Kapur and Vaishnav (2011) argue that real estate developers are leading financiers of elections. Since politicians retain discretion over permits, clearances and land conversion, a symbiotic relationship naturally arises. Kapur and Vaishnav (2011) examined patterns in the consumption of cement – the indispensable ingredient for construction – and found that it declines as elections approach. They infer that this happens because builders are cash-strapped as they have channeled funds out of their operations into political campaigns.

In Andhra Pradesh, all the major infrastructure players have two interesting things in common: they are either politicians or close relatives and most owe enormous sums to public sector banks. These businessmen started out as subcontractors to large projects and subsequently acquired land and became infrastructure developers themselves. Since infrastructure projects requires regulatory clearances and bank funding (typically from the public sector), a majority of them invested in developing close political connections or became legislators themselves in order to influence outcomes.

Rustomjee (2015) traces one such phenomenon:

> [A]s one example of this bizarre debt fueled growth, consider Lanco. The company had operating profits of Rs. 16.8 crore in 2005–06 and ran up a debt pile of over Rs. 35,000 crore a few years after that. How on earth could a bank lend such large amounts to Lanco against a servicing base that was so small to begin with? Even if the debt went into building assets, the pace of asset creation is extraordinary, and far beyond even common sense parameters of commercial lending.

It is evident that in Andhra Pradesh, the conjunction of big business and public sector bank debt can only be sustained by politics as "managing the environment" ensures "managing the business" (Bamzai, 2014). The total amount owed just by the state's five leading infrastructure companies, now under various levels of distress, amounts to about Rs. 140,000 crore ($22 billion) (Chabbria, 2015).

Venu (2015) argues that the real essence of cronyism flows from how deeply the link between business and politics is embedded in the larger system and no individual politician has the power to alter this. Further, he notes:

> The Indian banking system, for instance, is today saddled with about Rs. 5 lakh crore [$78 billion] of what may be described as bad and vulnerable loans. A substantial portion of this is lying in the balance sheets of a dozen family-owned business houses in the country who are politically well-connected and have used their clout to set up businesses ranging from roads, power, telecom and construction largely on borrowed funds from public sector banks. These businesses are regarded as too big to fail and therefore get endless support from banks.

Even though India has Debt Recovery Tribunals and is protected by strong laws such as the Securitization and Reconstruction of Financial Assets and Enforcement of Security Interests Act, the banking sector regulator Reserve Bank of India's governor Raghuram Rajan stated that debt recovery has often been erratic and delayed. In 2013–2014, the Debt Recovery Tribunal was only able to recover Rs. 305 billion ($4.75 billion), a mere 13 percent of the total outstanding debt (Bamzai, 2014). The ability of some industrialists to thrive in good times as well as bad has been described by Governor Rajan as "risk-free capitalism" (Venu, 2015).

The changing contours of the businessman–politician relationship

Over the last few decades, businesses bankrolling politicians in exchange for diverse favors was a prominent feature of India's political ecosystem. However, at the dawn of the 21st century, a new trend can be observed with businessmen taking the political plunge. They now find it more convenient to wield influence by becoming an integral part of the system. They are ready to invest in running for office in the hope of controlling the levers of government to further enhance their personal wealth.

In recent years, elected representatives in the states and at the center have included steel tycoons, large contractors, hotel barons, infrastructure developers, retired CEOs of Fortune 500 companies, media barons, tobacco kings and mining lords. Roughly, 120 out of the 788 Members of Parliament (MPs) are primarily businessmen, a contrast to the scenario prevailing in earlier decades when businessmen did not enter parliament at all (Bhushan, 2013). The Congress, although financed by business houses during the independence movement, brought its first businessman into parliament only in 1984 when it nominated industrialist K. K. Birla.

Sinha (2010) estimates that businessmen constitute 22 percent of the Lok Sabha and 16 percent of the Rajya Sabha. These figures have seen a gradual increase over the last decade. Kapur and Vaishnav (2011) also argue that wealthy individuals not only contest elections but also bankroll political movements on their own. In their view, the phenomenal rise of the BJP in Karnataka may be linked to the support of the Reddy brothers who made a fortune in mining. In return, the Reddy brothers were awarded prominent cabinet positions when the BJP came to power. (Their clout has since decreased after one of the brothers, G. Janardhana Reddy, was arrested for illegal mining).

Karnataka has also thrown up other interesting examples of businessmen-turned-politicians in the recent past. In the early 2000s, two of the leading liquor barons Vijay Mallya and Sri Hari Khoday took the electoral plunge (unsuccessfully). While Mallya was the national working president of the Janata Party, Khoday launched his own political outfit, the Devaraj Urs Samyukta Paksha (Karnad, 2012; Riti, 2004). Incidentally, their entry into politics coincided with the adoption of a new liquor policy of the state government that had supposedly put their businesses at considerable disadvantage. These two industrialists, who together held a sizeable share of the liquor market, were known to be big contributors during election campaigns.

The "Cash for Ticket" phenomenon has also become prominent in recent years. Bahujan Samaj Party chief Mayawati openly seeks monetary contribution from businessmen in exchange for her party's nomination (Vaishnav, 2011). She asserts that these funds are used to subsidize popular candidates who might not otherwise be monetarily well-off. In recent times, a Rajya Sabha ticket has reportedly commanded from $7.5 to $15 million. Businessmen perhaps perceive this amount as a small investment to ensure that they influence policy in the interest of their businesses.

More recently, an MP with substantial interests in the *beedi* industry (cheap cigarette made of unprocessed tobacco) was found to be part of a parliamentary panel studying the harmful effects of tobacco (Sharma, 2015). The same panel had earlier recommended putting on hold a notification making it mandatory for all tobacco packets to carry a pictorial warning covering 85 percent of its principal display area. The MP had personally written to the committee that *beedis* have "nil" harmful effect, a gross misrepresentation of the actual reality.

Institutional checks on crony capitalism

In spite of rampant crony capitalism, India's economy continues to grow at a formidable pace. A key reason could be the presence of robust countervailing forces that keep the excesses of crony capitalism in check and create a fairly level playing field in many sectors. These countervailing forces include some strong institutions, policy initiatives aimed at increasing transparency and a vibrant civil society.

India has a number of regulatory institutions with an impeccable record of professionalism. The Reserve Bank of India and the Supreme Court have largely remained untarnished. Kapur (2005) suggests that certain "referee" institutions, especially the Supreme Court, the Election Commission, and the Presidency have undergone "rejuvenation." The Supreme Court has sometimes donned an executive hat by affecting key issues of public policy through its rulings on public interest litigations. Its orders helped to improve air quality in New Delhi and triggered investigations into corruption in natural resource allocation. Independent constitutional bodies such as the Finance Commission make decisions about revenue sharing between central and state governments that are not questioned. The CAG actively pursues cases involving the potential misuse of political power. Goyal (2013) terms these developments the deepening of horizontal democracy and argues that it has resulted in better governance.

Crony capitalism has certainly affected India's public sector banks and saddled them with substantial amounts of bad debt. But the government has initiated reforms that will help shield the sector from political pressures to an extent (Yadav, 2013). Changing the method through which natural resources like telecommunication spectrum and coal are allocated, that is, moving from discretion to auction, has made impropriety harder. E-governance initiatives have helped tackle low level graft by eliminating middle men from processes such as train reservations, bill payments and the acquisition of driver's licenses. The passage of the Right to Information Act, with financial penalties for officers who delay their responses, has considerably improved the transparency and responsiveness of the system. Thus, India's ranking in *The Economist*'s cronyism index has gone down. Fewer rents could thus lead to even fewer rent-seekers.

Civil society has also assumed a vibrantly assertive presence in India. Kapur (2005) suggests that civil society plays two distinct roles: a direct one, in delivering development outcomes, and an indirect one, striving to hold public institutions accountable. The India against Corruption movement in 2012–2013 was an example of civil society coming of age. It brought together a range of activists on a single platform, had the broad support of citizens from across the country and galvanized youth and the urban middle class into participating in political protest.

An explosion in the number and range of print, broadcast and online media outlets has strengthened transparency and accountability and enhanced public scrutiny. However, new challenges have cropped up. The phenomenon of "paid news" has now become a hard reality. In the 2014 elections, out of 3,053 cases alleging paid news registered by the Election Commission, as many as 694 cases were confirmed as paid news (Bhakto, 2014). However, the Election Commission is yet to send formal intimation to the Press Council of India, the body mandated to take action against erring media organizations even though many months have elapsed since the elections. The challenge associated with prosecuting cases of "paid news" was even recognized by the Parliamentary Standing Committee on Information Technology headed by Rao Inderjit Singh. In its report presented in May 2013 it observes that although there is a well-established procedure to take action for such violations, the problem is to establish the violation itself *per se*. There are so many different ways which can be adopted toward obliging the (newspaper and television) channels financially that it is extremely difficult to establish a violation in this regard (Standing Committee on Information Technology, 2012–2013).

For the Indian media though, discussion of paid news remains taboo. The Press Council of India (PCI) set up a subcommittee comprising Paranjoy Guha Thakurta and K. Sreenivas Reddy to examine the paid news phenomenon. When their damning report was scheduled to be released, every effort was made to suppress or dilute its content. The PCI eventually released a watered down version of the report without any of the specifics detailed in the original which explicitly named newspapers and channels – including some of the biggest groups in the country – seen as having indulged in the paid news practice. The original report was reduced to a mere footnote. The Council decided that the report of the Sub-Committee may remain on record of the Council as a reference document. This "reference document," which traces the emergence of the paid news phenomenon over years and phases was – despite many of the PCI members insisting on it – not even annexed to the "final report." It is not available even for "reference" on the PCI's website (Thakurta and Reddy, 2010).

In 1943, even before India achieved independence, the architect of India's Constitution, Babasaheb Ambedkar, had warned of the danger posed by the fusion of money and politics: “These days, with the Press in hand, it is easy to manufacture great men. . . . In establishing their supremacy our great men have taken the aid of big business and money magnates. For the first time in our country, money is taking the field as an organised power” (Varadarajan, 2014). His words ring true even today as corporate houses are increasingly buying out media companies. Diktats spelling out editorial limitations follow.

When India’s largest conglomerate, Reliance Industries, took over the Network18 Group, commentators raised doubts on whether editorial integrity would be maintained in the new entity (Bahree, 2014). Within weeks of the takeover, CNN-IBN’s editor-in-chief Rajdeep Sardesai resigned over increasing interference by the management on what the channel could air and not air. As Karnad (2012) argues: “You don’t control newspapers by controlling the news – you control newspapers by choosing editors.” Subsequently, Sruthijith (2014) reports that after the RIL takeover of Network18, there were no stories on Arvind Kejriwal or the AAP for a period and AAP leaders were not invited to panel discussions on the channel. This was perhaps in retaliation against Kejriwal’s accusations that RIL chairman Mukesh Ambani had colluded with the government to raise gas prices to the benefit of his company.

Sruthijith (2014) also reports that when Amit Shah was named BJP president, CNN-IBN’s night bulletin as well as the graphics on air were edited to remove references to the criminal charges faced by Shah. This was allegedly done on the instructions of Umesh Upadhyay, the RIL representative now in charge of operations of Network 18. Umesh Upadhyay is incidentally the brother of the Delhi BJP chief, Satish Upadhyay.

The rapid growth of the Indian media has generally been viewed as a positive development. It was believed that the media would be able to serve as a free and fearless watchdog by facilitating greater accountability of public and private institutions and its various stakeholders. However, with the independence and integrity of the media now in question, only time will tell whether India’s media successfully stands its ground as the fourth pillar of Indian democracy or on the contrary further sells out to vested interests. Perhaps social media, which is substantially free of corporate control, will emerge as the watchdog.

Conclusion

This chapter has argued that the demand for political funding is a key driver of crony capitalism in India. By this logic, finding alternative methods to meet that demand could be the first step toward breaking out of this vicious cycle. To get started with such an effort, we would need to modify India's legal framework which remains in deep denial about the fact that maintaining a vibrant democracy comes at a cost.

For example, India has election expenditure limits which are unrealistic and counterproductive (Gowda and Sridharan, 2012). Consider that in the private sector a marketing campaign aimed at reaching two million consumers can cost a minimum of Rs. 100 ($1.55) per person. But to reach two million voters, a candidate cannot spend more than Rs. 3.50 ($0.05) per voter. Feeding volunteers and sending a postcard to each voter would exhaust that budget. Enacted with the good intention of making elections accessible to people of modest means, the low limits ignore the numerous legitimate expenses associated with election campaigns.

Election expenditure limits have driven campaign spending underground and have forced MPs to under-declare expenses, as former prime minister A. B. Vajpayee's quote above illustrates. They end up favoring the tainted over the sainted as only candidates with illegal money and the networks and capacity to spend it can thrive under such conditions. The increased presence in legislatures of candidates facing criminal charges as well as their comparative re-electability is one perverse fallout of this regulation. The solution, then, is to make election expenditure limits realistic or to eliminate them altogether (Gowda and Sridharan, 2012).

India also needs to acknowledge that competitive political parties and election campaigns are central to the health of democracies. Parties need legitimate ways of raising funds. It is worth recalling that Mahatma Gandhi introduced the *char-anna* (four pence) membership for the Congress. Through small contributions, he made the masses a stakeholder in the freedom struggle. Existing laws allow individuals, corporations and electoral trusts to contribute to registered political parties by check and to get their taxable incomes reduced by that amount. However, this facility does not apply to donations to individual candidates and needs to be amended (Gowda, 2013). Otherwise this regulation skews the funding process toward parties and inhibits the viability and strength of individual candidates by centralizing the control of party funds.

Even though open, tax-deductible contributions are legal, most funding still takes the form of cash donations. An alternative method of addressing demand is through state funding. If people want good governance and clean politics but most are unwilling to pay for it, then it is the government's duty to provide citizens with what they desire by drawing on the taxes they pay. Thus far, apart from indirect subsidies, like free time on the state-owned electronic media since 1996 and tax deductions for donations to parties since 2003, the state does not directly help political parties defray their costs of elections (Gowda and Sridharan, 2012).

State funding of parties and elections can take many forms. One proposal would have the government reimburse any party that receives more than 2 per cent of the votes polled at the rate of Rs. 100 ($1.55) per vote. This money is to be deposited in the party's bank account at the constituency level. The local unit of the party can use these funds during and in between elections for legitimate political activities. While this solution has some limitations, it can strengthen grassroots units of parties and enable them to nurture candidates who do not need to break the law in order to succeed as politicians (Yadav, 2011).

Universally, election costs have been acknowledged as the root cause of corruption and democracies continually try to address this challenge. Western European countries typically have a combination of public subsidies and small sum, grassroots financing. For example, Germany matches the amounts raised by parties from private sources. Neither contributions nor expenditure are limited and only the identity of large donors needs to be disclosed. Over time, this has resulted in parties raising private funds mostly through small contributions and membership dues (Gowda and Sridharan, 2012).

The government can also improve the political process by corroborating candidates' declaration of their assets and liabilities against their tax records. This will enable the government to investigate those candidates whose wealth has grown disproportionately to their known sources of income. Currently, though candidates have to provide this information, the ECI does not cross-check candidate affidavits with tax authorities so under-reporting and undervaluing of assets are commonplace.

The larger issue is about political careers. For democracy to flourish, there needs to be intense competition to become an elected representative. Given India's population, politics is a costly, full-time job. Prospective candidates need significant resources to keep in touch with voters, to mobilize politically, to stay active in the party, and so on. Becoming a politician is also highly risky career-wise and the costs are stacked against people of integrity. India needs to find transparent ways to enable clean, capable candidates to pursue political careers. Until we find ways to attract good people to politics in a truly sustainable manner, until we find ways to ensure that parties can raise and spend funds openly, India will not just be the world's largest democracy, it will also be the world's largest hypocrisy.

Notes

1 The views expressed in this chapter are personal and do not represent or claim to represent the views of the Indian National Congress party in any way.
2 The authors would like to thank Avinash Gowda, Anmol Dutt Mehta, and others for their comments on earlier versions of this chapter.

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8

Family Oligarchies and Crony Capitalism in India

Arup Varma, Biyun Hu, and *Lisa Bloomquist*

Introduction

In this chapter, we address the issue of family oligarchies in India, and explore how they impact the form of capitalism practiced in India. As India works to move from its socialistic-leaning economy of almost five decades (1947–1991) to an open capitalist model, it is often faced with roadblocks in its efforts. One of those barriers comes in the form of family oligarchies, which often control and thereby restrict access to natural, material, and financial resources, and thus to business opportunities. This leads to a situation whereby the system benefits a miniscule percentage of the population – those who are part of the families that control the resources, or who are favored by such families. The oligarchic model is most visible in the political sphere in India, where someone or the other from the Nehru family has been in power for most of the time since India's independence in 1947. The concentration of political power in one family is rather ironic given that India is the world's largest functioning democracy of over 1.2 billion people. As oligarchies, by design, restrict the free entry of others into the system, India will need to dismantle them to create a level playing field.

The term "cronyism" derives from the word "crony," which is based on the Greek word "khronios," meaning "long-standing." According to *Dictionary of Word Origins* (1990), crony is used to mean "friend of long-standing." Indeed, the term "cronyism" first appeared in the literature around 1840 with the meaning of "the ability or desire to make friends," but the meaning changed sometime in the 1950s, after a *New York Times* columnist used it to describe the political practice of appointing friends to government posts regardless of their qualifications.

The related concept of crony capitalism is essentially an extension of the notion of cronyism as it applies to the businesses and firms in a nation or society (Khatri, 2011b). Morck and Yeung (2004) define crony capitalism as a situation whereby a large portion of a country's corporate assets are controlled by a few families. It should be noted that crony capitalism is prevalent and can be observed in many countries/cultures, although it might be manifested differently in different countries (Khatri et al., 2006).

Given the extent of cronyism in India, the question as to why it has flourished in that country is a pertinent one. Enderwick (2005) argues that cronyism can help overcome some drawbacks of an open market system, by helping identify new market opportunities through targeted efforts of those in the know. Indeed, cronyism is often used by governments to help make investment and growth possible even during turbulent times – and this gives the governments a semblance of credibility. Here, people in government, whether elected or otherwise, call upon their contacts (friends, family, business folk with whom they have done business in the past) to make investments in various sectors, so that the economy may grow. The government representatives ensure that potential barriers are removed and the process of doing business is simplified, to make the entry of their contacts smooth and relatively easy. Indeed, the high growth rates and significant increases in income in East Asian countries during the 1970s and the late 1990s are often attributed to government-sponsored cronyism.

Cronyism is often listed as one of the key factors that actually led to the Asian financial crisis of 1997 (*Asiaweek*, 1999; Dale, 1999). In this connection, the Greenspan/Summers/IMF (GSI) thesis (Greenspan, 1998; IMF, 1997; Summers, 1998) has argued that it was crony capitalism, coupled with poor corporate management mechanisms and lack of competition that induced Asian companies to seek market share rather than profits, which ultimately led to the crisis.

While there are undoubtedly some positives associated with crony capitalism, the negatives associated with the practice may outweigh its benefits. For example, cronyism and crony capitalism have significant impact on governments' legislative, executive, and regulatory actions (Roberts, 2010), as these decisions need to be manipulated and designed to support the beneficiaries of the crony system. Further, cronyism and crony capitalism are often related to statism (Cammack, 1990), a phenomenon whereby government intervenes in the private sector by becoming a partner, financier, or even owner of business enterprises, which can undermine the very tenets of a free economy. Next, and perhaps even more importantly, such manipulations of the political and economic system can sometimes threaten the stability of a democratic society. According to Husted (1999) and Vogl (1999), it is the existence of cronyism that often leads to corruption and complacency in business, negatively impacting the economy and undermining competition. One unfortunate outcome of such collusion between government and the "chosen few" is that the spoils of business are available only to a few members of the society. As Morck and Yeung (2004) have argued, cronyism can affect economic process at both the micro and macro levels – at the micro level it can lead to resource misallocation, while at the macro level it can negatively affect innovation, economic growth, and economy-wide resource allocation.

To understand the practice of crony capitalism and the existence of family oligarchs, we need to look back at Indian history and culture.

Crony capitalism in India: a historical background

According to Mazumdar (2008), the first phase of cronyism in India can be traced to the beginning of India's experiment with capitalism – in an ironic way – with the arrival of the British East India Company which promptly declared monopoly over Indian business and trade. Of course, in order to gain control over a vast country like India, the British had to adopt their well-known policy of "divide and rule" (see Christopher, 1988), which necessitated creating in-groups and out-groups among the citizens. Given that India was then made up of innumerable kingdoms which were often at loggerheads with each other, it was not that difficult for the British to establish their empire, with the help of their "cronies." All they had to do was to identify the weak links in the Indian culture, and exploit those. In this sense, India's diversity proved to be a liability for its people, as the British were able to exploit the differences and create in-groups and out-groups, a basic requirement for cronyism. Thus, it is easy to see that the seeds of cronyism were planted during the British colonization of India, which lasted for over two centuries. As a result, cronyism and crony capitalism became institutionalized in the Indian business sector. However, it is important to acknowledge that while the British might have introduced cronyism for their own benefits, it is the Indian culture that absorbed it, and allowed it to flourish.

In fact, after India gained independence in 1947, the Indian government designed policies that resulted in the government controlling businesses by means of restrictive licensing policies, and being involved in various ways with the business world by controlling imports and exports, requiring approvals for foreign collaboration, and controlling capital issues. Further, scarce resources were distributed to well-known business houses with close connections to the government, with the result that few large business houses acquired and maintained control over resources as well as over banks and financial institutions. For example, 20% of the licensed industrial investment approved by the government from 1957 to 1966 went to the Birla Group alone. Ironically, the era of liberalization since 1991 did not reduce, let alone end, the crony capitalism in India. Contrary to the misconception that liberalization of the licensing regime and loosening economic controls would mark the end of crony capitalism, the economic liberalization of the 1990s simply gave it a renewed vigor, and this culture permeates the Indian state to this day. In this connection, Jagannathan (2009) has argued that the Indian political system is venal and its government business is almost always corrupt, leading to the need for people to become crony capitalists, having relationships with politicians, if they are to benefit from doing business with the government. Not surprisingly, India scores 43.3 on the Business Freedom Index (*The Heritage Foundation*, 2015), and is ranked 165th globally. Some observers attribute India's poor business environment to its crony capitalism. So, what is it about Indian culture that makes it susceptible to crony capitalism? We alluded to the notion of diversity earlier in our discussion, but would now like to address it at some length.

India is a country with diverse cultures and religions that have coexisted for centuries. Indeed, the analysis of Indian culture can be traced back to five to six thousand years ago, when the Vedas were written (Husain, 1992). One of the unique features of the Indian culture has been its ability to continuously evolve by absorbing a myriad of diverse influences – thus, Indian culture can be classified as an amalgam of Vedic culture, Buddhism, and Hindu culture, with clear Islamic and British influences. Not surprisingly, Indian culture combines various ethnic, religious, linguistic, caste, and regional collectivities together, with evident differences among the various groups (Budhwar et al., 2011). According to Sharma (1984), the ways and styles of living, land tenure systems, occupational pursuits, inheritance, and succession rules in India are all good reflections of its diversified culture.

We can better understand Indian culture and how it impacts cronyism by referring to Hofstede's (1977) dimensions of cultural difference. Compared to a world average of 56.5, India scores 77 on power distance, meaning that differences in status and hierarchy are accepted. Thus, leaders tend to be paternalistic, and followers expect to have clear direction and are prepared to follow orders (Khatri, 2009). Paternalism is more common in countries scoring high in power distance (Hofstede, 1997). So it is not surprising that cronyism is prevalent in India. Next, India has an intermediate score of 48 on individualism, which means India has both collectivistic and individualistic traits in its society. Specifically, on the collectivistic side, Indians are expected to belong to a particular large organization and act in conformity with in-groups, and thus lots of business decisions are largely dependent on relationships. On the other hand, India's individualistic side can be traced back to its dominant religion – Hinduism. As Hindus, people in India believe in a cycle of death and rebirth, and believe that they themselves are responsible for how they lead their lives, which will affect their rebirth. According to Khatri et al. (2006), cronyism is most likely to occur in vertical collectivistic cultures, which emphasize in-group relationships and respect for authority. Although India has an intermediate score on individualism, its emphases on relationship and conformity to in-groups can be seen as reasons why cronyism has flourished in India.

In sum, India might be a country with the most diverse but coherent culture in the world (Budhwar et al., 2011). Indians tend to have a strong belief in fate, accept inequality, respect authority, and value relationships; thus it is not surprising that crony capitalism in India translates into the existence of powerful family oligarchies and businesses. In the following section, we discuss family oligarchies and family businesses.

Family oligarchies, businesses, and business groups

Khatri and Ojha (Chapter 4 in this book) have rightly noted that the *oligarchic/clan corruption*, the kind of corruption observed in the Indian context, consists of a disorderly, sometimes violent scramble among contending oligarchs/clans seeking to parlay personal resources (e.g., mass following, a business, a bureaucratic chief, judicial or organized crime connections, or a powerful family) into wealth and power. For example, Gupta (Chapter 9 in this book) describes how many civil servants use their position to amass wealth. Seen in light of this assertion, it is clear that cronyism is one of the most serious issues afflicting the Indian economy. By using their political connections, a few families have created a sense of being above the law, thus harming the whole Indian society. It is easy to see the nexus between the political and business dynasties in India.

In most countries, family businesses are important sources of economic development and growth (Olson et al., 2003). They are generally designed as for-profit organizations producing products and services that are created and managed by people who have kinship and business relationships with one another. Employees of family businesses are seen as people who have received the positions due to their proximity to the family, rather than as individuals who have achieved the positions due to their knowledge, skills, or abilities (Keleş et al., 2011).

Family businesses that control very large industries and institutions can be seen as family oligarchies, as due to their control of resources, they also control and command significant amounts of power. Clearly, this is a situation that favors powerful families, and one that they would like to perpetuate and maintain. Indeed, in many countries and across all levels of economic development, there are a few really wealthy families that control big companies (Fogel, 2006). According to Claessens et al. (2000), the top families in many Asian countries control a significantly large part of listed corporate assets. As an example, the top 15 families in Hong Kong control 84.2% of assets as a proportion of GDP; similarly, the top 15 families in Malaysia control 76.2% of corporate assets in Malaysia, while this number is 48.3 for Singapore.

Next, as one might expect, nepotism is generally prevalent in family businesses. Nepotism can be defined as "inter-generational transfer of management" (Scoppa, 2009), so the founder of a family business tends to hand over the business to their heir, rather than to a business professional (Bertrand & Schoar, 2006; Burkart et al., 2003), which might have a negative impact on the organizational performance (Pérez-González, 2006).

Clearly, the practice of nepotism is contrary to the very ethos of an open market economy, whereby individual achievements should be commensurate with individual merit and effort. So, for example, those who work harder than others should get higher rewards, and those whose qualifications and experience make them better suited for higher positions should be hired for those positions. Of course, it is clear that even in a system devoid of cronyism, this relationship would not be perfectly linear, but it is the existence of cronyism that skews the relationship substantially. As can be seen in most countries, businesses are dominated by family-owned groups if economies are characterized by cronyism (Claessens et al., 2000).

It is interesting to note that some scholars have suggested that cronyism can reduce recruitment costs of companies (Bellow, 2003), although this is a somewhat narrow view of organizational practices, since cronyism is also likely to have a negative impact on organizational productivity, justice, motivation, and harmony (Arasli & Tumer, 2008). Specifically, family-member employees are likely to be evaluated leniently in family businesses, which can result in lower levels of efficiency (Lubatkin et al., 2005; Schulze et al., 2001, 2003).

Naturally, employees who are not family members are likely to feel that they are treated unjustly, as they are most likely to be held to a different standard. As a result, they may quit the organization (Arasli et al., 2006), and, in extreme cases, may even harm the organization by bad-mouthing the organization and its owners and managers (Arasli & Tumer, 2008). It is also important to note here that trust levels are usually rather low in family-owned businesses (Keleş et al., 2001). This is worthy of attention since trust is a critical determinant of organizational culture and performance, and has been found to be significantly positively correlated with several key determinants of organizational success – collaborative behavior, leadership, and team spirit (Jones & George, 1998; Mayer et al., 1995; McAllister, 1995), organizational commitment, and employee satisfaction (Huff & Kelley, 2003).

Perhaps the news is not all bad when it comes to oligarchies. Indeed, some researchers have argued that oligarchic family firms are able to perform better in countries such as India, Indonesia, and Taiwan (Khanna & Rivkin, 2001). In these nations, family-owned businesses are able to survive and succeed despite poorly functioning institutions. Of course, this may also have something to do with their ability to get close to those in power, and it may be this unhealthy nexus that shows positive results in the short term.

Relatedly, Singh and Zammit (2006) have argued that the primary reason behind the Asian crisis was not poor governance, poor competition, or cronyism, but financial liberalization without proper controls. However, other studies have suggested that family oligarchies suffer from numerous weaknesses that hardly compensate for some of the advantages that such businesses can offer. In fact, numerous empirical studies have demonstrated that family-owned businesses often underperform. For example, some heir-controlled Canadian firms show low financial performance, low R&D spending, and low patent filing rate (Morck et al., 2000). Similarly, some politically connected companies have been documented to be underperformers (Faccio, 2003), even though they have better access to financing, have lower taxation, and stronger market power.

According to Morck and Yeung (2004), family-controlled companies are more likely to be rent-seekers which thrive in corrupt societies with low trust levels. Perhaps most importantly, Fogel (2006) concluded that there is negative correlation between oligarchic family control over large companies and social economic outcomes. Specifically, the more control wealthy families have over big corporations, the less the economies of these countries succeed, especially in terms of income equality, health care, education, and infrastructure development. Not surprisingly, family-controlled firms are more prevalent in countries that often lack basic institutions, like law and order establishments and universal access to education. In order to keep their status quo, these families use their power to achieve political advantages and shape institutional development, which harms competition, innovation, and growth. Moreover, there are more oligarchic families when the government is more bureaucratic and more interventionist, when there are more political rent-seeking opportunities, and when financial markets are less developed.

Of course, diversified business groups exist almost all over the world, and dominate the corporate sector of India and other emerging market economies (Pattnaik et al., 2013). These groups generally include independent firms and operate in various industries, while family-controlled groups are bound by informal ties (Khanna & Yafeh, 2007), and tend to be more common in countries where rules of laws are insufficient and transaction costs with outsiders are high. Ironically, it is this type of family ownership or control of businesses and resources that is the leading reason for the existence and continuance of corruption and cronyism in societies.

As we note above, cronyism is one of the most serious issues afflicting the Indian economy. By using their political connections, a few families have created a sense of being above the law, thus harming the whole Indian society (Khatri, 2011b). According to Krishnakumar (2013), 60–70% of the GDP of most developed and developing countries are contributed by family business, as is the case in India. Indeed, about 90% of businesses in India are family owned, and non-family companies have to depend on family-owned ones more or less in different ways. Further, family businesses have played the dominant role in India's private sector since its independence from Britain in 1947. At that time, family businesses, such as Tata, Birla, Sahu Jain, Walchand, and Thapar, controlled most of the Indian manufacturing sector (Ray, 1979). However, after gaining independence, India adopted a socialist model. As a result, lots of state-owned and state-run enterprises were formed, and the scope of private sector activities was restricted by legislation such as the Industrial Policy Resolution of 1948 and 1956, which introduced a licensing regime. Further, some of the industries were reserved for the state sector (Khera, 1963). These restrictions were further strengthened, and entry into many areas was restricted by a monopoly legislation passed in 1969, which also applied to foreign investment (Dandekar, 1992). As a result of these restrictive practices and policies, Indian family business entered almost any and every area where they were able to get licenses. Not surprisingly, these businesses enjoyed high profits because the licensing policies permitted protection from imports and competition (Mohan, 1992). In addition to drawing significant benefits due to restrictive licensing and import policies that favored the families, these families were often also involved in helping set these policies (Government of India, 1969). Of course, the said policies also resulted in inefficiencies and a lack of global competitiveness of both private and state sector enterprises (Ahluwalia, 1985; Dandekar, 1992). In 1950, India's exports share was 2.0% of the world, while in 1990 it dropped to 0.56% (Mohan, 1992).

India changes course

After almost four and a half decades, the Indian government changed its trade policy on July 4, 1991, and moved from a state-controlled socialist economy to an open market capitalist economy. The new policy was designed to liberalize the Indian economy and reduce government control gradually. As a result of this major change, most sectors were removed from the licensing regime, and only defense, sectors of strategic concern, and petroleum were still reserved for government (Joshi & Little, 1996). As a result of de-licensing and liberalization, India's family-owned businesses had to face competition from other Indian firms, imports, and multinational corporations that were now free to invest in India (Manikutty, 2000).

However, as we noted earlier, the liberalization policies of the early 1990s have not done away with the existence of family oligarchies and their influence over and control of the Indian economy. In 2008, *The Economic Times* reported that India had 55 billionaires for the US$1 trillion of GDP, the second-largest number of billionaires per trillion dollars after Russia. The primary wealth resources for these billionaires are land, natural resources, and government contracts, all of which are a direct result of the families' close contacts with government officials and ministers (Gandhi & Walton, 2012). Thus, it is not surprising that in 2008, the total market capitalization of 11 Indian business groups were reported to be US$300 billion, about 30% of India's total market capitalization (Dutta & Dutta, 2008).

Corporate governance involves both formal and informal institutions. Formal institutions include courts, legislatures, bureaucracies, and state-enforced rules such as constitutions, laws, and regulations, while informal institutions are unwritten rules generally created and enforced through unofficial channels (Helmke & Levitsky, 2004). In India, business groups are the most important informal institution (Estrin & Prevezer, 2011). According to Peng and Jiang (2006), when formal institutions such as legal and regulatory institutions are weak, family-controlled business groups are beneficial. Heugens et al. (2009) support this finding by noting that family ownership concentration is an efficient strategy for corporate governance when legal protection for minority shareholders is imperfect. Specifically, Li et al. (2006) explain that business group structure, a horizontal strategy of diversification, is best suited to deal with market failures, including failures in capital markets and managerial labor markets. In India, failures in capital markets are caused by the inability of companies to obtain investment to expand and grow (Khanna & Palepu, 2005; Khanna & Yafeh, 2005), since money is controlled by a few banks whose first priority is to act in accordance with government to invest in the industrial sector, and foreign capital is also limited as governance norms are weak (Li et al., 2006). Since large business groups in India can surmount financing difficulties, Estrin and Prevezer (2011) concluded that informal constitutions, especially group businesses, are good substitutes for inefficient formal ones.

Business groups represent a form of economic organization, engage in various businesses, and are characterized by centralized and concentrated ownership and control (Cazurra, 2006; Granovetter, 1994), and firms within the business groups share productive resources (Penrose, 1959). Family business groups are business groups controlled and managed by particular families. The family linkage–based business groups represent "particularistic" cultures (Granovetter, 1994; Luo & Chung, 2005), in which crony capitalism is able to flourish. In India, business groups are often considered as the legacy of colonial rule (Saxena, 2013).

Ironically, business groups, in some way, are more appropriate or even beneficial for India. This is because in emerging market economies like India, external markets are either underdeveloped or lack effective regulations and governance for trade, contract enforcement, and communication, which then lead to poor information disclosure, information asymmetry, and high transaction costs (Khanna & Rivkin, 2001). Internal capital markets, on the other hand, are favorable in efficient resource allocation and low transaction costs (Gertner et al., 1994; Stein, 1997). In such circumstances, business groups are able to allocate scarce resources within the same business group more efficiently by using their internal capital, labor, and product markets; are able to decrease transaction costs arising from information asymmetry between investors and the firm by utilizing internal markets efficiently; and are able to overcome market imperfections by using vertical integration in the product market (Khanna & Palepu, 2000; Leff, 1978; Li et al., 2006).

However, business groups have also been the subject of several specific criticisms. First, business groups, especially those with higher use of internal capital markets, are less transparent compared to unaffiliated firms (Pattnaik et al., 2013). Corporate transparency, the disclosure of a firm's information to the public (Bushman et al., 2004), plays a significant role in the corporate governance and functioning of healthy capital markets (Healy & Palepu, 2001). In such aspects, business groups might need to improve transparency by disclosing credible information, and the government might need to devise effective corporate governance polices and develop external market institutions (Pattnaik et al., 2013). Next, scholars like Chatterjee and Nankervis (2007) have blamed business groups as the primary reason for the Asian crisis, because of their complex ownership structure, opaqueness of functioning, and their vested interest in promoting and even perpetuating crony capitalism. Finally, business groups have often been seen to be lacking in matter of ethical practice, since they have been reported to engage in unethical behaviors such as expropriating minority shareholders and looting assets of their affiliates (Morck & Yeung, 2004; Scharfstein & Stein, 2000).

In India, the last few years have seen several financial scams that have cost the exchequer huge amounts of money, and made citizens lose faith in the ability of the government to operate in a transparent and fair fashion. Some business groups were involved in these scams. This is perhaps the main reason why the Indian population gave a thumping majority to the Narendra Modi–led government in the parliamentary elections of 2014. It is worth mentioning here that the country is still trying to deal with, and recover from, the economic impact of these fraudulent activities of some of the business groups. We next provide specifics on some of these.

Recent scams and mismanagement

The first major scam involving a family business that we discuss is that of Kingfisher Airlines founded by Vijay Mallya, the Indian liquor and beer baron, in 2003. Ever since the airline commenced operations in 2005, it had been stumbling and suffered severe financial losses (see *The Hindu*, September 4, 2014, for a detailed timeline). Eventually, the Directorate General of Civil Aviation suspended Kingfisher's flight license on October 20, 2012, and revoked its license on February 25, 2013. The fact that Kingfisher Airlines became insolvent and had to be closed down after just seven years' operation gives enough reason to investigate the reason(s) behind this failure. While there seemed to be several missteps in the management of the airline, including its acquisition of Air Deccan, inefficient operations, and huge debts, Mallya blamed it on high taxes and the ever-increasing price of oil, caused by rising interest rates and a falling rupee. Interestingly, in August 2010, Mallya was appointed a member of the consultative committee for the Ministry of Civil Aviation, once again raising questions about the nexus between government and industry, and the unhealthy attempt by some in the business world to impact policy matters such that their own businesses were favored (*The Hindu*, 2014).

Ironically, the Indian government refused to bail out Kingfisher – perhaps because the government itself had a large budget deficit, and had been already pumping hundreds of millions of dollars into the unprofitable state-owned carrier Air India. Not surprisingly, most public officials in India hold the opinion that the government should not help a private airline.

The second major scam is the 2G spectrum telecommunications scam that involved politicians, bureaucrats, and family businesses. In 2008, under the Telecom Minister A. Raja's lead, 122 new 2G (second-generation wireless telephone technology) licenses were issued to telecom companies at a price much lower than market and on a first-come-first-served basis. As a result, several licenses were given to firms that had no prior experience in the telecom sector and did not meet eligibility criteria, including firms like Unitech and Swan Telecom (see, e.g., *Livemint*, February 09, 2011). The Comptroller and Auditor General of India estimated the difference between the money collected and the money that the law mandated to be collected to the tune of Rs. 1766.45 billion (US$28 billion).

In 2011, the 2G spectrum scam was listed by *Time* magazine as its number two of "Top 10 Abuses of Power." In 2012, by stating that Raja's action appeared as if he "wanted to favor some companies at the cost of the public exchequer" and that he "virtually gifted away important national asset," the Supreme Court declared the allotment of 2G spectrum "unconstitutional and arbitrary" and abolished all the licenses issued in 2008 during his tenure. (IBNLive, 2012).

The third scam, the coal allocation scam (see, e.g., Dalal, 2014), which led to a major political scandal, involved the allocation of the nation's coal blocks by the Indian government to public sector entities and private companies. The Comptroller and Auditor General of India accused the Government of India of allocating coal blocks in an inefficient manner, rather than using time-honored efficient practices, such as competitive bidding. The end result was that the exchequer lost an estimated

US$37 billion, since both public sector enterprises and private firms paid less than they might have otherwise. During the investigation, the Central Bureau of Investigation officials speculated that bribery may have been involved in the allocation process.

In 2014, the Supreme Court announced a final rule to scrap all but 4 of 218 coal blocks allocated by the government from 1993, a much more severe ruling than the industry was hoping. In Sushil Jacob's (a lawyer at a London law firm) opinion, the result sent a clear message about India's determination to move against the improper allocation of national resources and in favor of improving transparency and good governance (Mohanty & Das, 2014).

Conclusions and recommendations

As we discuss above, family oligarchy and crony capitalism almost always seem to go hand in hand. Although various studies have shown the weaknesses of cronyism and family oligarchies, there are also examples of economies (e.g., China and India) that have done well while also having serious corruption and cronyism issues. Further, most oligarchic family-owned businesses in India do outperform their non-family business counterparts. Indeed, Stiglitz (1999) has argued that there may not be sufficient justification to reject the Asian way of doing business. Similarly, Singh and Zammit (2006) assert that the Asian business model, which is characterized by cooperation between business and government, is more likely to be conducive to economic growth and social welfare, compared to the US model, which is speculative and conflictual. In this connection, Tripathi (2011) has predicted that family businesses in India would decline, while Saxena (2013) argued that it would be hard for Indian business groups to continue flourishing as family-/kinship-based economic organizations, with family disputes and lack of succession planning being the two main impediments to their sustainability. Indeed, many group businesses, such as Singhanias, Modis, Kirloskars, and DCM-Shrirams, have been badly affected due to the lack of planning. Additionally, the "source of stagnation" perspective indicates that large and matured family groups within advanced economies are likely to choose business strategies that are less innovative and more conservative, and this is why many second- and third-generation family firms start to underperform (Gedajlovic et al., 2012). On the contrary, Yabushita and Suehiro (2014) have argued that in imperfect markets, family business groups can survive, and even prosper, if they can overcome three management resource limitations – lack of investment funds for new projects, insufficient production technology and market knowledge, and a dearth of professional human resources.

From a national and organizational performance perspective, cronyism leads to a decrease in productivity, performance, trust, and morale. Cronyism ultimately leads to poor decision making at the top, which is not conducive to survival in today's competitive environment. Of course, from the perspective of in-group members, cronyism is certainly advantageous as it leads to significantly better outcomes for them. However, as the examples of the scams discussed above show, the end result is often disastrous for the nation's economy, and ultimately, its people. In India's case, it is all the more critical that the economy is seen as transparent, so that multinational corporations can continue to see India as a preferred destination for them to do business. Indeed, since the early 2000s, India has been pegged as one of the leading economies of the world (Wilson & Purushothaman, 2003), and has seen substantial increases in the inward flow of foreign direct investments (Varma et al., 2008). However, many multinationals are hesitant to invest in India due to the amount of red tape and corruption prevalent in the country (see Khatri, 2011b).

We would like to conclude this chapter on a positive note, by arguing that all is not lost, and there is still hope for recovery. The overwhelming majority given to the Bharatiya Janata Party in 2014 by the electorate is a clear sign that the people of India wanted to see a change. Among other critical issues, such as poverty alleviation, the issue of corruption was front and center during the election campaign. Given that it has been over a year since the elections were held, all signs point to a sea change in the way India does business. Prime Minister Modi and his cabinet have made many significant changes, and the general mood in the country is very positive. We are also hopeful and confident that a new India is emerging where talent and hard work are rewarded without heed to one's background and without the need for family connections.

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9
Indian Administrative Service and Crony Capitalism

Vishal Gupta

Introduction

In 1947, independent India embarked upon the long and arduous journey of planned socio-economic development and nation-building for establishing a welfare state and an egalitarian social order with social, economic, and political justice, equality, liberty, and fraternity for every citizen. The developmental experience of India during the last half a century has been a mixture of successes and failures. While India is now considered to be one of fastest developing and rapidly growing economies of the world, it is still home to the largest number of poor worldwide. With the $2-per-day poverty line as a point of reference, in 2010 some 68.7% of the Indian population could be considered poor (Bertelsmann Stiftung, BTI, 2014). With a Human Development Index score of 0.586 in 2014, India ranks 135 of 187 countries worldwide in human development (UNDP, 2014).

Various international agencies suggest that corruption is ubiquitous in India and corruption and cronyism remain one of the most important challenges that India faces at present (Transparency International, 2014). Corruption in India occurs in two basic forms: administrative and policy (Subramanian, 2015). Administrative corruption occurs at the point of public service delivery through payment of bribes to access or expedite these services. Policy corruption occurs when decisions to allocate public resources are distorted by money, power, access, connections, or some combination of the foregoing. Administrative corruption fits the basic definition of corruption. Policy corruption may be more damaging, systematic, and hard to contain than administrative corruption and fits the notion of crony capitalism more appropriately (Subramanian, 2015). Backroom deals between members of the governing class and their hand-picked cronies influence the legislative, executive, and regulatory actions of governments and are not only morally hazardous, but toxic to economic freedom (Roberts, 2010). Cronyism and corruption pervert policy and rob the best ideas of legitimacy (Shourie, 2009). Aspiring entrepreneurs, willing to work hard and full of ideas and energy, start out against a stacked deck because they lack political and family connections. To get ahead, they need a system that maintains non-discriminatory markets and impartial credit allocation, as well as rewards for individual success (Roberts, 2010).

The Indian Administrative Service (IAS) had a strong beginning with support from Sardar Vallabhbhai Patel, one of the eminent leaders of the freedom struggle who referred to the Indian Civil Service (ICS – predecessor of the IAS during the British Raj [rule]) as the steel frame of the country, representing the essential spirit of the Indian nation – unity in diversity. Speaking in the Constituent Assembly in October 1949, Sardar Patel had remarked, "You will not have a united India if you do not have a good All-India Service which has independence to speak out its mind" (cf. Benbabaali, 2008). While ministers and political parties come in and go out of power, IAS officers stay and form a permanent part of the executive branch of the government, thus providing continuity and neutrality to the administration. IAS officers have a national outlook and are viewed as generalists who can assume a diverse array of responsibilities over their careers and move around the country from various state assignments to the national capital (Radin, 2007).

IAS officers are recruited by the union government on the recommendation of the Union Public Service Commission (UPSC) and are posted under various state cadres. The officers carry high respect and stature in the society coupled with the significant task of administering important public offices, making it one of the most prestigious jobs in India (Kumar, 2010). The appointing authority is the President of India, and while the respective state governments have control over the officers, they cannot censure or take disciplinary action against an IAS officer without consulting the union government.

Far from the lofty beginning espoused by Sardar Patel as noted above, the years since independence have been marked by a steady deterioration of Indian bureaucracy. Time and again, questions have been raised about the imperviousness, wooden-headedness, obstructiveness, rigidity, and rule- and procedure-bound attitude of the bureaucracy (Godbole, 2001). The bureaucracy has not only become inefficient, it has also become highly corrupt. According to a recent survey of the bureaucracies of the 12 Asian economies, India's "suffocating bureaucracy" was ranked as the least efficient, and working with the country's civil servants was described as a "slow and painful" process (Rana, 2012). Indian bureaucrats are said to be a power center in their own right at both the national and state levels, and are quite resistant to reform that affects them or the way they go about their duties (Saxena, 2010). According to a top IAS officer, the clean and motivated proportion of the 5,000 members of the IAS is just about 10% today while at the other end of the spectrum 15% are "scum" (*The Economist*, 2014).

Given the significance of the bureaucracy (the executive branch of government) in India's development, the aim of this chapter is to analyze and discuss the relationship between the IAS and crony capitalism. The chapter is structured as follows: in the next section, I discuss the external forces impacting on the bureaucracy (IAS) resulting in its dismal performance, followed by an analysis of the internal forces affecting its performance. Based on the analysis of external and internal forces, I provide recommendations for improving the efficiency and performance of the IAS.

External forces, the IAS, and crony capitalism

Apolitical services to committed services

As the Indian democracy has evolved, Indian politics has transformed into an unregulated business (Subramanian, 2015). The electorate in India is splintered into tiny fragments. In the Lob Sabha (the Indian equivalent of the House of Commons) elected in 2009, 99% of the members were elected by a minority of those entitled to vote; 92% were elected by fewer than 40% of electors; 58% by fewer than 30%; and 17% found their way in by securing the votes of fewer than 20% of electors (Shourie, 2009). The result of this fragmentation is that a significant number of legislators have criminal records, including convictions for the most serious offenses such as murder. One would not expect reforms and good governance as the priorities for such individuals. The political system both in states and at the center seems accountable not to the Indian masses but rather to those who are behind the elected members of legislative assemblies (MLAs) and members of Parliament (MPs); they often include contractors, mafia, corrupt bureaucrats, and manipulators who have made money through the political system (Saxena, 2010).

The founding fathers of the Indian polity wanted the IAS to be apolitical, independent, fearless, and upright in tendering advice to the government. Over the years, most of the governments, both at the center and in the states, have not deployed IAS officers in the spirit in which they were meant to. The idea of apolitical services has been transformed into committed services. The civil servants of today are prepared to crawl when asked to bend and are prepared to do the bidding of their political masters, often anticipating their wishes (Godbole, 2001). There are multiple ways to coerce, cajole, and subdue honest officers. Some of the important ones are discussed below.

Transfer mania

The arbitrary transfers of government servants have become a part of the daily routine of present-day governments (both states and center). Many a time, transfers are used as an instrument of punishment. Transfers have become a lucrative industry in several states and there is no possibility of its being de-licensed even in this era of economic liberalization (Godbole, 2001). Whenever a new government is elected, the first thing it does is to transfer the IAS and Indian Police Services officers. For example, the Bharatiya Janata Party (BJP)–Bahujan Samaj Party (BSP) coalition government in Uttar Pradesh in 1995 transferred 600 officers in its 135-day tenure (Singh, 1997). Taking cognizance of this shocking state of affairs, the High Court of Uttar Pradesh noted that "all governments in the last decade had been responsible for making transfers and postings a lucrative industry and that government servant[s] were being treated like shuttle-cocks to be banged and battered around frequently on political, caste, monetary and other extraneous considerations" (Godbole, 2001).

During the ICS days under the British, officers had a fixed posting of three years as district collector/deputy commissioner and were never transferred without their expressed desire to do so (Kothari, 2001). Now, bright men and women join the IAS, but the adverse work environment, constant political interference, frequent and often meaningless transfers, and corruption below and above them, all lead to the death of idealism and encourage them too to misuse their authority (Saxena, 2010). It becomes very difficult for an officer to learn and understand all the issues in a district of a population of more than 10 lakh and more than 600 villages. At times, an officer is transferred within just a few months of one posting and as one would expect much of this time would be spent not in planning programs but in dealing with issues of moving to the new posting (Kothari, 2001).

Misuse of the Central Bureau of Investigation (CBI)

The honest officers are harassed and humiliated as if they are doing something that is against the interests of the country (Shourie, 2014).

Compounding these problems is the misuse of the CBI by successive governments to harass foes and protect friends. A few recent cases that have caught the country's attention are of those of Ashok Khemka and Durga Shakti Nagpal. Khemka is a senior IAS officer in the Indian state of Haryana and is best known for his honesty and for canceling the mutation of Sonia Gandhi's son-in-law Robert Vadra's illegal land deal in Gurgaon. Khemka received death threats (*India Today*, 2012), two charge-sheets (Kamal, 2013), and 46 transfers in a career spanning 22 years (Siwach, 2015). Nagpal, a civil servant and officer in the Uttar Pradesh cadre of the IAS, launched a drive against corruption and illegal sand mining within her jurisdiction of Gautam Budh Nagar and was suspended by the Uttar Pradesh government for allegedly demolishing an illegal mosque wall in a village in Greater Noida. Her suspension was revoked by the Uttar Pradesh government subsequently only after severe opposition from the association of Indian bureaucrats and the general public (Zanane, 2013). In 2013, the CBI registered a case against an IAS official, P. C. Parekh, in the allocation of the Talabira coal block in 2005. Parekh had a high reputation for integrity, and had actually raised questions about the allocation. Similarly, the CBI moved to investigate the secretary of the disinvestment ministry for the disinvestment of Udaipur's Laxmi Vilas hotel on the basis of an oral complaint, 12 years after the decision (Shourie, 2014).

It is not uncommon that bureaucrats who have displeased influential politicians or taken a principled stand against their ministers are victimized and humiliated, without anyone coming to their rescue. When a young district collector with two school-going children is repeatedly transferred from one place to the other, or an outstanding officer gets a rotten posting, his idealism takes a heavy beating. The bureaucracy is the creation of the prevailing political system, and a thoroughly corrupt and self-serving political system cannot foster an honest and public-spirited bureaucracy (Gill, 2001).

Indian socio-cultural context

Culture provides a comprehensive framework for understanding the various facets of work behavior. Cultural values and social habits are the societal means of coping with environmental exigencies and historical legacies (Sinha, 1990). For example, the developmental values of justice and equal opportunity for all have arisen out of the nation's disgust with corruption, crony capitalism, poverty, and inequality, and the resultant aspiration to catch up with the developed West. The external realities and the historical legacies have shaped significantly India's societal culture that plays an important role in determining the work culture of government offices and bureaucrats. The relevant setting for the concern for work (or lack of it) may be a cluster of organizations located in a geographical or socio-political region having its own features and demands on the people who live in that region (Sinha, 1990). An analysis of the Indian bureaucracy will be incomplete without talking about the socio-cultural values and systemic features of the surrounding milieu within which it is situated.

Hierarchical social structures and relations

Indians are highly status conscious. The historical legacy of caste system that fails to die in the society has had such a pervasive influence on the Indian psyche that there is a high acceptance (and at times expectation) of hierarchy and high power difference with bosses and subordinates. Indians feel comfortable in the superior–subordinate framework, and peer group relationships induce anxiety till the peers are ranked on some real or imaginary dimension (Khatri, 2011; Sinha, 1990). Unquestioned power is an invitation for corruption and crony capitalism. Seeking and retaining power, whether personal or collective, and the desire to be secure corrupt the mind and bring about its decay (Krishanmurti, 1977, as cited in Verma, 2010). Each individual has vested interest which she is consciously or unconsciously protecting, watching over and not allowing anything to disturb. Self, consciously or unconsciously, uses activity or profession as a means for its own gratification, for the fulfillment of its ambitions, or for the achievement of success in terms of power (Verma, 2010). Bureaucrats are clothed with immense power. A district magistrate is the chairman of close to 80 committees that are responsible for the development of the district. When the power comes with subservient subordinates and people who are afraid to speak out openly against corruption and wrongdoings, it is likely to encourage cronyism. Thus, societies having high power distance may be at a disadvantage when it comes to human development and progress.

Own–other dichotomy

Indians prefer loyalty and dependability over efficiency and independence (Khatri, 2011; Sinha, 1990). They find it easier to work in paternalistic relationships (i.e. superior–subordinate roles) rather than with equals (Sinha & Sinha, 1990). They prefer personalized relationships based on their societal values of deference (*shraddha*) and affection (*sneh*). The role of the superior is to provide guidance, protection, nurturance, and care to the subordinate, and the role of the subordinate, in return, is to be loyal and deferent to the superior (Aycan et al. 2000; Khatri, 2011). Kakar (1978) noted that Indians are more sensitive to (or concerned with) not the goals of work but emotional affinity. Such a work culture is bound to lead to administrative inefficiencies, favoring of own and interests of known people, and lack of trust and credibility, all ideal breeding grounds for cronyism.

Indians are to a greater extent still more parochial in thinking, feeling, and behaving. They are more accustomed to thinking in terms of narrow identities like their own selves, castes, communities, regional, and linguistic groups, which are constantly being reinforced by the government's actions (Desai, 2008), and eroding the work culture in Indian organizations. The social structures and rent-seeking behaviors that existed at the time of independence have been maintained and even expanded (Osborne, 2001). The feature of embeddedness with one's in-group (Sinha, 1990) has been found to lead to problems like regression of trust and a credibility gap resulting in caste-based group formations (Verma, 2010).

In the early period of the IAS, not only were most politicians from the Congress party but they were also from some of the same caste and communities as the IAS members. Both were composed of elites within the Indian society. Today, however, given the conflicts between politicians in the states and those at the center, it is not surprising that some individuals perceive a higher level of political conflict because the politicians and IAS members come from different communities (Radin, 2007).

Amoral familism

Poverty and its allied maladies have been so pervasive and extreme in India that even the well-to-do Indian in the post-independence era suffers from a poverty syndrome (Sinha, 2000). Poverty syndrome manifests in a fear of getting poor, becoming a failure in the face of odds, or running into unanticipated misfortune. Even those who are well-off fear to lose their possessions and scared that their children may become poor. Poverty syndrome leads to *amoral familism* that is characterized by a compelling concern to favor family and friends at the cost of community and public interest, thus leading to cronyism. Amoral familist Indians, hence, manifest a disposition to acquire and hoard material resources by adopting any – even corrupt – means, pursue narrow interests, and run after short-term gains (Verma, 2010). The most effective way to do so is to acquire, consolidate, and enhance power that enables them to accumulate more wealth, and also makes them immune from being censured for their wrongdoings. This is the classic case of cronyism.

Socialist economy and big government

India remained a closed, socialist economy till 1991 when the economic reforms were introduced. The license-permit-quota-raj, consisting of stifling controls, influenced prices, production, capacity, investment, imports and exports, capital markets, banking and finance, land, and labor during 1950–1980 (see Khatri and Ojha, Chapter 4 in this book). It provided for collusion between politicians and bureaucrats to generate money to run parties and fight elections, and later became a means of generating personal income and wealth (see Gowda and Sharalaya, Chapter 7 in this book).

The government plays a pervasive role in determining the health of an economy. It runs a number of public enterprises and operates key sectors like railways, mining, and power. In addition to playing an extensive role in agriculture, the government oversees the management of the social sector, particularly health care and education. Furthermore, as a regulator, the government's role is both broad, spanning most economic and welfare activities, and deep, including the micromanagement of several sectors of the economy, and price control and policy making for the private sector. As a result, its resources and managers are so overstretched that they cannot do justice to any area, let alone those that need attention and resources the most: basic education, primary health care, poverty alleviation, and rural infrastructure.

Commenting on the connection between big governments and crony capitalism, Jagannathan (2009) observes that India has a "high-cost and venal political system" where "government business almost always means corruption" and to "benefit from it, you have to be a crony capitalist, a friend of politicians." He further notes "large government is invariably accompanied by crony capitalism. Reason: When government spends more, private companies do more business with it." Another classic example of crony capitalism at work is in the government procurement sector. A recent Heritage Foundation report concluded that foreign companies win less than 1% of the contracts in the gigantic, government-funded Indian infrastructure construction market (Scissors, 2010).

It is true that the Indian bureaucracy became bloated and autocratic; this unfortunately might have been only adaptation by the bureaucracy to the political and social policies of the government. It had to grow to implement the ever-expanding role of government. It became autocratic only because it was representing an omnipotent government (Deshmukh, 2001). Given this situation it is easy to imagine both the opportunities and the discretion that is at the disposal of an IAS officer to make easy money.

IAS characteristics and internal factors

Nothing changed: ICS of British era continued

The Indian bureaucracy has never been able to shed its colonial paternal syndrome to assume the role of a public service provider (Gill, 2001). To be fair to the modern brand of politicians, it must be admitted that except for high integrity, neutrality toward party politics, and provision of minimal administrative services in times of emergency, the civil service even in the times of the British Raj had little to commend itself. Efficiency in the civil service was always narrowly defined; it was in terms of contempt for politics (Indian political parties) and adherence to rules, but never in terms of increased public satisfaction (Burra, 2010; Saxena, 2010). About the public administration, Jawaharlal Nehru wrote (Gill, 2001; Singh, 2005):

> But of one thing I am quite sure, that no new order can be built up in India as long as the spirit of the ICS pervades our administration and our public services. Therefore it seems to me quite essential that the ICS and similar services must disappear completely, as such, before we can start real work on a new order.

Nehru had seen from close quarters the working of the Indian bureaucracy and had been at its receiving end for nearly two decades before he made this observation. He set up several committees to overhaul the system. But the colonial bureaucracy has remained intact (Burra, 2010). There is little indication that those who oversee the IAS have attempted to acknowledge that the more than 60-year-old system has been or should be modified to deal with the changing times and a new India. Some now even argue against the continuation of the IAS. The 2002 report of the National Commission to Review the Working of the Constitution argued that the "steel frame" of the IAS was not even a "cosmetic change" from the colonial era ICS and is thus a relic of a colonial past (Radin, 2007).

Unfortunately, there are little signs of flexibility and change in the way the new IAS recruits are trained at the Lal Bahadur Shastri National Academy of Administration (LBSNAA). Radin (2007) analyzed the curriculum of the foundation course for IAS officers at the academy and observed that there has been little change in the curriculum that was being taught a decade ago; there is little discussion on the problems of corruption, dealing with politicians, serving as a bridge between the people and the politicians, and issues of secularism the new officers face;

the curriculum does not deal with the need for officers to find ways to creatively integrate separate national policies at the local level; the economics section of the syllabus does not include detailed attention to the new global economy and India's role within it; the only mention of center–state relations is found in the subject area called political concepts and constitution of India.

Most of the faculty and directors at the academy are individuals who are veterans of the service who – not surprisingly – focus on the subjects and the teaching style that they experienced during their own training period. There is little acceptance of outsiders (management teachers, professionals) and willingness to hear new ideas. The IAS officers operate the academy as their government departments with a strict sense of hierarchy. Outside faculty are usually not invited to the academy as they do not understand the pulls and pressures experienced by an IAS officer. The faculty who teach the young officers is not exposed to teaching methods that are interactive and involve problem-solving techniques rather than traditional lecture classes. Some faculty members appear to view the foundation course as a way of preparing officers for their first district-level experience; others do not seem to emphasize that experience (Radin, 2007).

The colonial legacy, inflexible training, and disgust of the IAS establishment for political masters have ensured that the administrative accountability in India was always internal and upward, and the civil service's accountability to the public has been quite limited leading to greater incidents of cronyism (Saxena, 2010). Civil servants are just as comfortable with the status quo: the enterprises are as much a part of *their* empires as they are of the transient minister. Given the inclination of the minister, they are only too eager to show their usefulness by creating obstacles to the smooth functioning of public services.

Lack of professionalism

A high degree of professionalism ought to be the dominant characteristic of a modern bureaucracy. The fatal failing of the Indian bureaucracy has been its low level of professional competence. The IAS officer spends more than half of his tenure on policy desks where domain knowledge is a prerequisite. However, in the present environment there is no incentive for a young civil servant to acquire knowledge or improve his skills. There is, thus, an exponential growth in an officer's ignorance and arrogance. It is said that in the house of an IAS officer one would find only three books – the railway timetable because he is always being shunted from one post to the other, a film magazine because that is his level of interest, and, of course, the civil list, which describes the service hierarchy (Saxena, 2010). An important factor which contributes to the surrender of senior officers before political masters is the lack of any market value and alternative employment potential. Beyond government they have no future, because their talents are so few. Most IAS officers, thus, end up as deadwood within a few years of joining the service and their genius lies only in manipulation and jockeying for positions within the government. As described earlier, the foundation and the refresher courses that are being taught at the LBSNAA do not add any skills that may be useful to them in their careers outside bureaucracy.

Researchers studying the civil service examination of India question the examination as it can hardly be called a measure of the intelligence and creativity of the administrative abilities of the entrant (Das, 2001). Data from the annual reports of the UPSC for 2014 show that there has clearly been a gradual increase in the number of candidates with bachelor's degrees, while the number of candidates with higher degrees is declining (Union Public Service Commission, 2014). While the percentage of candidates having higher degrees was 62% in 1995, the percentage was a mere 37% in 2013. A similar trend is also visible with respect to the selected candidates. The number of successful candidates with bachelor's degrees has gone up while the number of those with higher degrees has come down significantly. The percentage of selected candidates having higher degrees in 2013 was 39% as compared to 65% in 2003. The data show that the pool of applicants is getting increasingly filled with candidates whose educational background is qualitatively lower than those in previous years.

Structure of reward and punishment

The reward system in a public bureaucracy can take the form of compensation, promotions, and placements in civil service assignments. It is the government that determines the level of civil service compensation in India based on the recommendations of the pay commissions set up from time to time. There have been, so far, six pay commissions set up by the central government. Since the first pay commission (1946–1950), the commissions have recognized the ever-widening gap between government and private salaries. While government employees naturally value job security, they also need a reasonable standard of living. Payment of high salaries by itself is not a guarantee for the honesty and integrity of the public service. But, the payment of a salary that does not satisfy the minimum reasonable needs of a government servant is a direct invitation to corruption (Ministry of Finance, 1973).

The sixth pay commission introduced a lot of measures to ensure that some parity is established between the salaries of civil servants and private sector professionals. The commission recommended a higher starting salary for civil servants and also recommended that the government should have the flexibility to offer a market-driven salary to highly qualified scientific and technical personnel whose skills are in demand in the private sector. In addition, the commission made suggestions with regard to the appointment to selected posts at higher levels on contractual and tenured basis where market-driven salaries could be paid in order to attract the best possible expertise to the government. Further, taking into account the fact that a large portion of the salaries in the private sector comes from performance-related payments, the commission recommended introduction of performance-related incentives in the government (Ministry of Finance, 2008).

The promotion process in the IAS followed in India is a closed multi-track model. An IAS officer is assured of at least four promotions in his career that spans more than 30 years (Das, 2001). There is no lateral hiring, and only the person who has entered the civil service through the entrance examination can ever become a senior bureaucrat. It is an accepted principle in management that the competent and meritorious individuals should be given faster promotions and better career opportunities (Gupta, 2014). While the concept of benchmarking has been introduced in grading of annual performance reports, promotions are finally made on the basis of seniority only as all civil servants usually have good appraisal reports (Adhia, 2007).

What is discomforting about the present promotion system is the almost guaranteed nature of promotions without any attempt at sifting the brighter and the more competent among the all-Indian services or relating the process of promotion to their performance. Time-bound promotions provide no incentive for officers to perform better than what they are capable of. When they see their counterparts in the industry getting promoted faster and earning more money, they are likely to indulge in corrupt practices so that they make money faster. According to a report by Kelly Services India, an HR solutions company, on salaries in the private sector, the salaries of employees beginning their careers in corporate jobs are at least 1.5 times higher than those who begin their careers in the IAS. The difference becomes wider as years of experience increase, and by the mid-state (10–15 years of experience), the gap widens to about 2–2.5 times. By the time the individuals reach the twilight of their careers (about 30 years of experience), the difference is anywhere between 3 and 5 times (Kelly Services India, 2013).

The experience of other countries is different from India. For example, Singapore, which now has the best bureaucracy in Southeast Asia (Rana, 2012), has periodically increased civil service compensation to bring it on par with the compensation in the private sector (Campos & Root, 1996; Das, 2001; Khandwalla, 1997). A civil servant in Singapore is one of the best paid in the country. Salaries of civil servants are reviewed annually and adjustments are made where necessary to keep pace with the market (Yong, 2014). By default, the civil servant gets an annual increase in pay (called merit increment) dependent on whether she performed well at work and on top of that a promotional increment (if she gets promoted to a higher job grade). The starting salary for a civil servant is based on her caliber (such as work experience, skills, educational qualifications, and personal qualities), demands of the job (such as the type of work and scheme of service that one is appointed to), and the prevailing labor market (Singapore Government, 2014).

The promotions in Singapore are entirely merit based. The merit of a civil servant is determined by her performance in the grade and by an assessment of the civil servant's ability to carry out the responsibilities and duties of the next grade. Reports of the supervisors on performance, recommendations of ministerial and departmental committees, and an assessment of the ultimate potential of the civil servant are taken into account for promotion (Das, 2001). In India, the promotion system is only remotely linked to internal merit and has, therefore, not succeeded in raising the stakes for corruption. The process of promotion is not one of healthy competition but only a rat race where many of the civil servants make use of power brokers, fixers, politicians, and top businessmen to get them into postings of repute and favor. Once in these positions, they are bound to return the support offered to them by indulging in acts of cronyism.

Transfers of civil servants in India are made with such frequency that fixity of tenure is an exception rather than the rule. The percentage of IAS officers spending less than a year in their current postings has ranged from 48% to 60% of the total strength of the IAS for the entire country (Anand, 2009). The percentage of IAS officers who spend more than three years in a current posting has been less than 10%. Wade (1982), writing on the Indian bureaucracy observed:

> The transfer is the politicians' basic weapon of control over the bureaucracy, and thus the lever for surplus-extraction from the clients of bureaucracy. With the transfer weapon not only can the politicians raise money by direct sale, they can also remove someone who is

> not being responsive enough to their monetary demands or to their request for favors to those from whom they get money and electoral support – in particular, the contractors. One is thus led to visualize a special circuit of transactions, in which the bureaucracy acquires the control of funds . . . then passes a portion to MLAs and especially ministers, who in turn use the funds for distributing short-term material inducements in exchange for electoral support.

Promotions and placements are a more selective and discriminating method to reward good officers than pay raise alone. In Japan, the promotions are merit based taking into account a combination of seniority and a number of performance indicators. Politicians in power have no inputs in the matter, thereby reinforcing the merit-based nature of the civil service system.

Business class and crony capitalism

Business and government are more often partners than adversaries when it comes to crony capitalism. While the primary responsibility for corruption lies with the political and bureaucratic class, we must also recognize that no bribe is received before it has been given. Of the ten biggest family firms by sales in India, seven have faced corruption controversies (*The Economist*, 2014). Until 1991, India had a license-permit-quota-raj, a regime of rules and quotas that could only be navigated with the help of bribes. However, liberalization of the economy post-1991 opened up a lot of avenues for cronyism. The value of mining licenses soared; privatizations and public–private partnerships became common, and prone to manipulation. According to the *Economist* (2014), the gains from rent-seeking over the past decade were estimated to be about $80 billion. If one were to assume politicians and officials got an average cut of 5–15%, then total bribes paid would amount to $4 billion to $12 billion. At some places, the nexus between businesses and government became so strong that separate cities were carved out. For example, at their peak the Reddy brothers ruled over Bellary having different rules for its people. Karnataka Lokayukta (Ombudsman) Santosh Hegde reported a brazen flouting of laws and the use of the administrative machinery to serve the interests of a few, turning the town into a "Republic of Bellary" (Verma, 2011).

Private businesses are a source of political corruption in India. A significant way in which businesses fuel corruption in India is through electoral funding of political parties (see Gowda and Sharalaya, Chapter 7 in this book). Unlike Western countries like the USA, India does not have national electoral funds that provide campaign money to the political parties for elections. It is common knowledge that the bulk of funding for the elections comes from private companies for services rendered in the past, and also for the promises of services to be rendered once voted into power, the only rider being that such funds are not publicly acknowledged by the giver or the taker (Das, 2001). The parties that come to power feel obliged to the business houses for funding them. Also, they would like to maintain good relationships for continued funding in the future. The vested interest of receiving money from the business sector motivates politicians to favor businesses and see to it that their work gets done with minimum inconvenience. It is no surprise then that in the past few years major industrialists have been found to have links with politicians like the Modi–Adani connection, Modi–Ambani connection, or Vadra–DLF connection (Balan & Damor, 2014; Malik, 2012; Press Trust of India, 2014).

The weaknesses in the bureaucratic framework and in the way different processes are conducted give businessmen an opportunity to milk the system to their advantage. The kind of collaboration that exists between administrators and private businesses in India is neither institutional nor systemic. In the past there have been several instances in which businessmen, through their political connections, have managed to install their favorite civil servants, who are understandably faithful protectors of their (the businessmen's) individual interests in top slots in the ministries of the government (Das, 2001). The personalized nature of such relationships has succeeded in creating and nurturing a culture which encourages the civil servants to distance themselves from civil society and be more conscious of the interests of the industrialists in India. An honest civil servant is coerced to act in favor of industrialists because if she does not, she is threatened with transfer or punishment by politicians who favor the private businesses.

The business class, which under normal circumstances would be expected to be a strong supporter of change, as a whole, is still under the spell of the license-raj. The core competence of many a business remains the ability to manipulate ministers and civil servants (see Khatri and Ojha, Chapter 4 in this book). Most of the businessmen would rather cut a private deal with the concerned minister or civil servant than work to change the system. Indeed, most of them would not think twice of the harm they may inflict on institutions and mores by the deals they cut. Overall, there has been, and is, great resistance to liberalization from the industrialists' lobby in India as it will level the playing field, open doors to honest and fair competition, and bring down the entry barriers.

Recommendations

As noted in the recent report of the Second Administrative Reform Commission, it is ironical that there has been no sincere attempt to restructure the civil service although more than 600 committees and commissions have looked into different aspects of public administration in the country (Kohli, 2010). The answers to the long-standing ills and deficiencies of the civil service will have to focus on both internal and external factors affecting the bureaucracy, as they reinforce each other. It is often forgotten that good governance is basic to any other reforms and changes in society. Everything else can be purchased for a price but not people-friendly, socially conscious, and clean administrators committed to the rule of law, respect for secularism, human rights, and the welfare of weaker sections of society.

The civil service of India needs a thorough transformation. In this section, I provide recommendations in two parts: (1) changes external to the IAS and (2) changes internal to the IAS.

Changes external to the IAS

The changes external to the IAS include the political will to change, increased civil society awareness, and a citizens' charter.

Political will to change

The examples of the turnaround of bureaucracies over the last 30 years from countries around the world like Australia, Canada, the UK, Malaysia, and Singapore show that political commitment to change is critical (Campos & Root, 1996; Khandwalla, 1997). The vast changes in many of the above-mentioned were driven by politicians. In Canada, the change was masterminded by the bureaucracy itself and had the necessary support of the political bosses. For reforms in governance, the political class needs to stand up, show commitment to change, and take responsibility for bringing in the change. A prime example of such leadership is Singapore's first prime minister, Lee Kuan Yew, who inherited a highly corrupt civil service but transformed it into a clean, efficient, effective, and exceptional public service. The Indian political class needs to take note of the rot in the bureaucracy and rectify it. Given the state of India's political class and problems of *amoral familism*, it is perhaps too much of wishful thinking to expect that politicians will drive the change. In such a case, classes that are making the new India – the entrepreneurs and the middle-class professionals – may have to weld themselves into a team of advocates. These classes may need to embrace the ethical universalism that has three features: (1) civil life involves active participation of citizens, (2) public office is not a privilege, but a civic duty, and (3) everyone is equal before law (Khatri and Ojha, Chapter 4 in this book; Mungiu-Pippidi, 2013). Further, "liberal ethics" is a prerequisite for any vibrant democracy (English, 2013; Khatri & Ojha, Chapter 4 in this book). The term "liberal" indicates a respect for liberty, autonomy, and equality of others, along with rights of person, property, and fair treatment. With the popularity of social media, it is now possible to make changes. Only when there is a consensus and public opinion against the present state of affairs will the political class be put under any pressure to bring about the needed changes. The anti-corruption movement by Anna Hazare in 2011 led to the passing of the Lokpal and Lokayuktas Act, 2013, in Parliament on December 18, 2013, paving the way for the establishment of an ombudsman to fight corruption in public offices and ensure accountability on the part of public officials, including the prime minister. It is important that more such pressure groups are formed so that the political class is made to act in favor of change.

Increased civil society awareness

Indian society has a culture of being fragmented into narrow identities of caste, religion, and region and has much tolerance of injustice and acceptance of power differentials. In such a society, it is unlikely that citizens will organize themselves to fight corruption (Das, 2001). The absence of social capital can be addressed through dedicated efforts for creating awareness. The public should be encouraged to report cases of corruption by being rewarded for doing so, just as they are currently rewarded for bringing to light cases of income tax evasion (Government of India, n.d.). Non-governmental Organizations (NGOs) can play a vital role in spreading awareness about anti-corruption activities and groups. Groups like Parivartan and Kabir used the Right to Information Act (RTI) to address citizens' grievances related to the Public Distribution System, public works, social welfare schemes, income tax, and electricity, thereby giving voice to the public. The NGOs were also instrumental in putting public pressure on the government to pass the RTI act in 2005. To ensure public support and participation, the activities of anti-corruption bodies should be publicized: details of cases, persons investigated, and action taken.

Hong Kong has taken a similar approach through its Independent Commission against Corruption (ICAC) with good results. The ICAC promotes the fight against corruption by advertising ways for citizenry to get involved in the government and raise complaints against corrupt officials. It conducts sessions in schools and colleges and publicizes steps that can be taken to control corruption in the country. Recent actions by some political parties in India (Ghose, 2015; HT Correspondent, 2014) like setting up of a corruption helpline, "janta darbars" (public gatherings or town-hall meetings where ministers hear the complaints of citizens) are a step in this direction and need to be reinforced. Citizens should be encouraged to participate in governance more. Only when there is an aware civil society, will pressure be created on the political class to bring in administrative reforms.

Citizens' Charter

Public service performance improvements need to be pushed by increasing expectations from consumers as much as they are pulled by management expectations (Commonwealth Secretariat, 1995). All countries that have successfully transformed their bureaucracies have adopted a citizens' charter (called as Clients' Charter in Malaysia and Service Charter in Australia, Service Standards Initiative in Canada, and the Citizens' Charter in the UK) to improve the quality and effectiveness of public services. The concept of citizens' charter was first articulated and implemented in the UK by the Conservative Government of John Major in 1991 as a national program with a simple aim: to continuously improve the quality of public services for the people of the country so that these services respond to the needs and wishes of the users. The UK's Citizens' Charter initiative aroused considerable interest around the world and several countries implemented similar programs, as for example, Australia (Service Charter, 1997), Belgium (Public Service Users' Charter 1992), Canada (Service Standards Initiative, 1995), France (Service Charter, 1992), Jamaica (Citizens' Charter 1994), Malaysia (Clients' Charter, 1993), Portugal (The Quality Charter in Public Services, 1993), and Spain (The Quality Observatory, 1992).

The idea of a citizens' charter was adopted in India in 1997 when large public organizations like the railways, telecom, posts, and public distribution systems were asked to formulate a charter listing out their performance indicators. During the year 2002–2003, Department of Administrative Reforms and Public Grievances evaluated the design and implementation of charters in 5 central government organizations, 15 departments, and the 3 states of Andhra Pradesh, Maharashtra, and Uttar Pradesh. As per the evaluation carried out, in the majority of cases charters were not formulated through a consultative process; by and large service providers were not familiar with the philosophy, goals, and main features of the charter; adequate publicity to the charters had not been given in any of the departments evaluated; in most departments, the charters were only in the initial or middle stage of implementation; and no funds had been specifically earmarked for awareness generation of the Citizens' Charter or for orientation of staff on various components of the Charter. On the other hand, there have been examples of significant improvements in government efficiency where timelines and expectations from government departments have been strictly defined. The Gujarat government adopted the idea of one-day governance where activities were identified that can be completed in one day (Adhia, 2007). The step has worked in achieving significant efficiency in the government administrative system.

The exercise of formulation of citizens' charters for departments in India has been a failure so far. This may be explained partly by the influence of Indian culture (see Billing and Farro, Chapter 6 in this book). The seriousness and consultation process is minimal or largely absent. It has been reduced to one of the routine activities of the government departments and has had no focus. If the civil service has to be improved, each and every government department needs to be mapped and performance expectations (measures) should be listed clearly. Citizens' rights, departmental responsibilities, quality of service, and time frame for providing the service should be clearly specified. Measures of customer satisfaction and of efficiency will have to be devised and institutionalized in order to put pressure on the civil servants and push them toward change.

Changes internal to IAS

The changes and reforms internal to the IAS include the following: recruitment and selection, agency-based restructuring, performance management, punishments, information technology, and financial discipline. I elaborate on these changes and reforms next.

Recruitment and selection

The bureaucratic structure in India is largely an insulated labor market. The system has been designed to ensure that, by and large, only those who enter the civil service through the examination system, and thus make the early commitment, gain access to senior positions (Das, 2001). There is no room for horizontal entry into top and middle ranks. Like the civil service in the UK (Khandwalla, 2010), India should aim to develop a cadre of professional senior managers to support ministers in policy formulation and implementation. These should be lateral entry contractual jobs with a well-defined career progression (Kohli, 2010). Managerial focus, leadership, innovation, communication, and professional competence should be among attributes that governments should seek in the senior civil servant (World Bank, n.d.). It should be more performance oriented and less process compliant than the general public service. Senior civil servants' selection should be about identifying good managers of the public sector and should consist of individuals who have had an outstanding record of running public or private businesses, and/or strategic planning and execution of large public projects. They should be selected by the UPSC on a competitive basis and placed at a level higher in terms of authority, pay, and prestige than the highest grade possible for IAS officers entering through the civil service examinations. Exceptional performers among those IAS officers who have entered through the civil service examination should also be absorbed into the senior civil service. Creating a senior civil service will break the insulation of the IAS and will present an incentive for the officers to work harder. Also, not only does this system open up the choice of top managers from a much wider pool, new entrants bring in their own "culture" which promotes renewal and innovation in public organizations.

Agency-based restructuring

Public bureaucratic departments should be converted into national-level and state-level executive agencies. The agencies should have executive functions within a framework of policy and resources provided by the ministry. Each executive agency should be headed by a chief executive selected from the senior civil service and should have considerable operating freedom subject, however, to the policy and resources framework. The chief executive should be appointed to the agency based on her preferences on a contractual basis for a block of five years that can be extended based on a periodical review. The chief executive should be assisted by a small team of civil servants who will report directly to her. Before forming an agency, however, some tough questions should be addressed: Should the agency be formed at all? If yes, could it be privatized or contracted out? Does the work overlap with that of other departments? Can multiple departments be merged into a single department?

Once the decision to form an agency is taken, the agency should come out with its citizens' charter clearly listing its mandate, objectives, performance indicators, timeframe for providing the services, and budget. The agencies should receive targets from the government/ministers and would be answerable to Parliament about the achievement of those targets. Apart from setting the targets, politicians should have no say over the day-to-day operations of the agency. The chief executive officers should be responsible for running the agencies in the manner they deem fit. They should be responsible for creating and abolishing positions, and for transferring, appointing, and promoting staff. At the end of the year, the agency should come out with an annual report providing information on its activities and achievement against targets. The chief executive officer, and not the minister, would be responsible for answering questions in parliament on the achievement of targets and on the performance of the agency.

Having an agency-based structure for bureaucracy has several merits. First, in line with new public management philosophy (Khandwalla, 2010), the structure will enable functioning of the Indian bureaucracy as a private sector organization. Second, the agencification of bureaucracy will break the influence of politicians on selection, appraisal, transfers, and promotions that is so solely needed in the Indian context. Third, the agency-based structure will make it mandatory to rethink and rationalize the work that is being done by the bureaucracy. Fourth, the agency-based restructuring will provide an incentive for civil servants to perform. In the agency structure, they would be made answerable to the chief executive who would have the power to even dismiss them for non-performance. Exemplary IAS officers should be absorbed into senior civil service and made chief executive officers.

Performance management

Effective reward and appraisal systems are the best way to introduce a performance orientation as they generate perceptions of procedural and distributive fairness (Adhia, 2007; Gupta & Kumar, 2013). As described above in the section on Indian culture, Indians are collectivistic, prefer loyalty over efficiency, have a strong sense of own–other difference and are great at ingratiation. Getting fair assessment in such a personalized and particularistic context is complicated. In the present system, every IAS officer gets good ratings from their supervisors irrespective of their actual performance (Adhia, 2007). One of the ways to break this cycle is to involve the citizens (customers) availing the service in the evaluation of IAS officers. The UPSC should have a separate wing that should be responsible for the performance appraisals of the IAS officers. The UPSC appraisal wing should be headed by representatives from former senior civil servants, distinguished judges, citizens, and academicians working in the sphere of public policy and social welfare. The wing should be responsible for the appraisals of chief executives only. All other officers working in an agency should be appraised through systems and processes set up by the agency. Achievement of the performance targets by the agency should be evaluated by collecting data from the customers (citizens) the agency served. The agency performance should solely determine decisions regarding pay and promotions for chief executives. For IAS officers who report to the chief executive, the agency performance should have part weightage (50%) and the ratings by chief executive should have the remaining weightage.

Good performers should be identified and adequately rewarded through both monetary and non-monetary incentives. To enable better performance and give officials stable tenures, chief executives and IAS officers should have tenures of five years in an agency. Some amount of career management should also be brought into the administrative service. Similar to the Indian Army, the postings of IAS officers should be categorized according to demand and difficulty so as to ensure that everyone gets a fair chance to serve on both important and difficult (such as in remote and tribal areas) assignments. A mix of postings should be created for all officers, and it should be ensured that each IAS officer has the easy and the difficult, the good and the bad of the service.

In order to make the bureaucracy growth oriented, it is essential to institutionalize certain key values in the governance and administrative system. Some of these values are quality in the public services, concern for efficiency and productivity, innovation in improving quality and productivity, discipline, integrity, and accountability. Training should be provided in the use of new technologies in management, ethics, and management of cultural diversity, people-related skills, and service quality. Language training for management of people of a multilingual society should also be provided. The training should largely be administered and coordinated by LBSNAA. The director of LBSNAA should be an academician who has been involved in training and research on bureaucracy/public policy for a substantial period of time and has made a significant contribution to the field. Today the director of LBSNAA is a bureaucrat who has little information of the latest trends in research, education, and training. LBSNAA should also empanel leading training institutes/agencies that would be willing to offer training programs.

IAS officers should be sent for regular training programs from time to time in order to pick up the essential skills needed to perform effectively at work. Mapping of the training needs should be one of the important tasks of the UPSC and training should be linked directly to the identified training needs. A proper record of the training attended by each officer should be maintained and a follow-up assessment on the impact of training on individual/group performance should be performed. While the training should be largely done at LBSNAA, short-duration training relating to specific topics can be planned with an external agency.

Punishments

All matters relating to corruption and misconduct of IAS officers should be referred to the central vigilance commissioner (CVC) which should have all powers to investigate cases and implement the judgments/decisions reached. The CVC should have full authority to enforce punishments once a decision has been taken. A time frame should be decided on beforehand within which the matter has to be investigated and decision reached. The system should be modeled on the lines of a court martial in the army, where a separate civil service court is set up to determine the guilt of the members of civil service and if the defendant is found guilty, to decide upon punishment. The civil service court should be able to try personnel for all kinds of offenses except murder and rape of a civilian, which should primarily be tried by a civilian court of law. Political and government authorities should have no interference in the functioning of the civil service court. As has been done in Japan and Singapore (Das, 2001), offenders and personnel found guilty of corruption should also be subjected to public shaming.

The CVC should have complete control over the central and state investigation agencies. The directors of the investigation agencies should report directly to the CVC who will have complete executive control over them. The CVC should be run in a manner similar to the Election Commission of India. A committee consisting of five members, namely, the president, the prime minister, the deputy prime minister, chief opposition whip in the Upper and Lower Houses of Parliament, should select the CVC. The commissioner should be free to choose his teams. The commissioner should have a fixed tenure of five years and should enjoy the same status and salary and perks available to the senior-most civil servant of the country. The CVC can be removed from office only through impeachment by Parliament.

Information technology

An office of Management Information Systems and Technology should be set up which would be responsible for adopting and implementing the latest available technologies and decision support tools for decision makers to conduct and coordinate the UPSC examinations; streamline various government procedures; automate routine processes to cut costs and the need for human intervention; design and conduct online surveys on agency performance; maintain detailed cost and income records for agencies; and maintain a central database of staff, staff reports, training, and all web portals for agencies. The confidentiality of government papers concerning all officers is always under question. Management information systems with respect to disciplinary matters concerning IAS officers should also be maintained by the office. All information about IAS officers, including their past performance, corruption scandals, wealth, judgments on them, achievements, and complaints about them, should be made online so that citizens can know more about their bureaucracy and hold them to account for non-performance. Each webpage relating to an IAS officer should also have a place where citizens/ customers can give feedback about the officer and lodge complaints about him.

A chief information officer (CIO) should be appointed by the UPSC to head the office. The CIO should be selected on a competitive basis by a committee comprising select senior civil servants, MPs, members of the judiciary and distinguished citizens. The CIO should be completely autonomous and should be free to create positions, select staff, identify performance measures, appraise performance of her staff and set up other HR systems. She should work with chief executive officers and help them in their work/problems. She should be appraised annually by the UPSC committee and should have no political interference in her work.

Financial discipline

Financial management initiatives should be taken to ensure that the agencies maintain financial discipline. Each agency should come out with the budgets at the beginning of the year that should be audited and cleared by a committee formed by Parliament. Beyond the auditing exercise, Parliament should have no role in determining how the money should be spent. Instead, the chief executive officers of the agencies should have full freedom to use the money allotted to them. At the end of the year, executive officers should submit a record of their expenditures to the parliamentary committee.

Agencies should be encouraged to identify means of generating revenues to offset the spending, so that total government spending can be controlled. For this, the user-pay principle as adopted in Australia and New Zealand (Khandwalla, 1997) can be explored. Agencies should be made to pay for availing the services of other government agencies. Agencies should become vendors to ministers, who can place orders with their agencies specifying standards of quantity, quality, timeliness, and cost. Ministers should also have the right of refusing to buy from agencies under their charge. Performance agreements between chief executives and ministers should be mandatory. Under such agreements the chief executives should agree to sell the outputs of their agencies at agreed-upon cost, quality, timeliness, and so on. CEOs should be evaluated at the end of the year on their performance and on the delivery of the outputs based on the standards decided upon earlier.

Conclusion

There is a striking similarity in the steps adopted by various countries that have tried to improve their bureaucracies. Asian countries like Malaysia, Singapore, Japan, and South Korea have been able to turn around their bureaucracies by adopting strict steps that had been proven in the West. Indian bureaucracy needs a complete overhaul if it has to live up to the expectations of its people. The present chapter has presented a brief description of the administrative reforms that are needed to be brought in. Figure 9.1 provides a diagrammatic representation of the changes suggested for the bureaucracy in this chapter.

In order for the reforms to be effective, there are some supporting conditions that are necessary: First, political commitment for the reforms is essential. The importance of securing political commitment for administrative reform is identified as a major influence on implementing successful public service reform. The India of today is showing positive signs of change when it comes to politics. The citizenry is becoming more vocal about its problems and is willing to rise above narrow boundaries

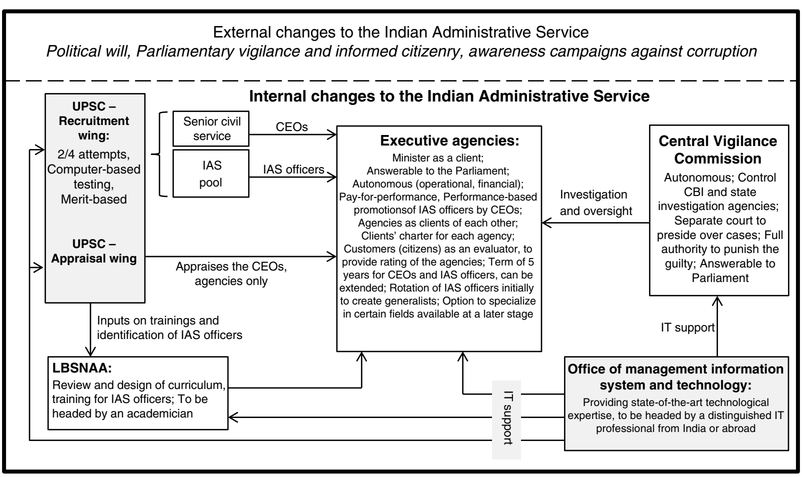

Figure 9.1 An overview of Indian administrative reforms

Note: UPSC – Union Public Service Commission; LBSNAA – Lal Bahadur Shastri National Academy of Administration.

of caste and religion to vote for parties that talk about development and growth. Second, ownership of change across the public service is vital. The public civil servants need to feel a sense of involvement in the way bureaucracy would be reformed and they should share the vision and want the change. Involvement of IAS officers in the change process from the very beginning can make the change happen faster. Countries like Canada and the UK began their change process by setting up task forces and scrutiny exercises that were headed by civil servants who had volunteered for a scrutiny, and evolved the needed changes.

Third, civil society's patience and support while the change happens would be needed. An effective public service serves and also draws support from a lot of groups like citizens' associations, NGOs, industry and trade associations, trade unions, academic institutions, and the media. These groups are sources of various skills, ideas, competencies, and commitments required for sustaining administrative reforms. Finally, there must be recognition that reform is a continuing, long-term process and that it will be continuous. The changes implemented should be assessed and reassessed for their effectiveness. Longer-term flexibility and willingness to change and innovate will be critical for the reform agenda.

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10
Indian Judiciary and Enforceable Measures against Crony Capitalism

Anil B. Suraj

Introduction

When can the courts review decisions made by the government? The answer is in a simple principle: if the concerned authority has "*come to a conclusion so unreasonable that no reasonable authority could ever have come to it*," [emphasis added] then the courts shall exercise their power of review.[1] Over the years, this dictum has not only formed the basis of several matters seeking review of governmental actions, but has also come to depict certain attributes of "unreasonableness." Foremost, the question of legitimacy and authority of the decision-maker is crucial in deciding whether the review must be considered and whether the impugned action must be set aside on the grounds of inadequate basis. Furthermore, there is an inherent element of questioning the rationality and logic of the action, and the grounds of irrationality or arbitrariness are most certainly subjected to the power of judicial review. Finally, this principle has also been interpreted to impose on the executive a duty to ensure that all their actions are within accepted moral standards.

Especially in the context of economic affairs, it is crucial to limit the prerogative powers of the government to overcome the prevalent spread of "crony capitalism" in India. In a legal system based on empirical traditions of common law, the courts under the Constitution of India have charted a purposive course of checking "the state" evidence of which is particularly forthcoming in the manner the Supreme Court of India has addressed issues of

(a) "discretion" in public contracts; and
(b) "negligence" in economic governance and related decision-making.

Indian judiciary[2]

The primary objective of any legal system is to guarantee the enforcement of rights as vested by the Constitution and the laws made thereof. The maxim *ubi jus, ibi remedium* captures the purpose of a legal system by stating that *where there is a right; there is a remedy*. Therefore, it is a common principle that only individual(s) whose rights have been violated could approach the courts for the appropriate judicial remedies. It is essential to first prove that a right exists; then that the particular right has been violated; and therefore a remedy is warranted. *Locus standi* is the term used to refer to the standing of the petitioner bearing a significant connection with the cause being disputed, and therefore, to be entitled for the deserving remedies. It is relevant to mention that the nature and process of judicial remedies that the courts guarantee in response to criminal offenses do not strictly require such elaborate construction of standing.

One of the most unique and the proudest features of the Constitution of India is that it provides for a fundamental right to approach the Supreme Court for constitutional remedies against the state (Article 32 of the Constitution). Given the mandate of the Constitution to the Supreme Court to enable "complete justice" (Article 142 of the Constitution), this fundamental right to access judicial remedies assumes significance. A strict or literal interpretation of the principle of *locus standi* would certainly dilute the guarantee of this fundamental right.

Remedies against administrative wrongdoing would necessarily depend upon the prompt and vigilant action by the citizen(s). But when the individual is pitted against the state it is always an unequal contest. Apart from the manifold procedural requirements/expectations, the time, effort and financial challenges to such an action are staggering. Therefore, a true and meaningful access to justice is possible only if such individual pursuit of legal remedies to hold administrative actions accountable is enabled.

It was against this background that the Supreme Court, through a set of decisions rendered in the late 1970s and early 1980s,[3] introduced the concept of "public interest litigation" (PIL). It was then increasingly felt that in various cases, because of the facts pertaining to prevailing social and economic circumstances, the petitioner approaching the Court may not be in a position to meet the burdensome requirements of the judicial procedure and evidence. Toward enabling better enforcement of fundamental rights, the Supreme Court gradually diluted the principle of *locus standi* by reasoning that

(a) it is the primary obligation and duty of the Court to protect, promote and enforce fundamental rights;
(b) in the larger interest of the administration of justice;
(c) for the purpose of enforcing public duty and redressing public injury; and
(d) protecting public interest in the form of social and collective rights.

Courts and jurists worldwide have appreciated this innovative measure undertaken by the Indian Supreme Court and much has been written about the benefits of PIL. However, PILs have also been the subject of much debate owing to instances of their abuse by frivolous or vested interests. Nevertheless, the creative jurisdiction of PILs has been instrumental in providing a wide canvas for the Indian courts to draw the precepts on accountability and transparency in executive actions.

"Discretion" in public contracts

Contracts are meant to represent the "consent" of the parties. It is presumed, given the relative bargaining positions, that the parties have consented to the various clauses only after comprehensive rounds of negotiations. Competency in understanding the business implications of the proposed transaction is also presumed. Therefore, laws governing enforcement of contracts are set on inferring and determining the terms of such consent. However, this is true for contracts involving only private parties.

If one of the parties to a contract is a "public" or government entity, then the contract is typically termed "public contract." The emerging nomenclature to identify a party that is "public" in nature is "bodies governed by public law."[4] In the matter of public contracts, the courts have evolved a different rationale for review. The overarching purpose is to determine fairness at all stages, and to enforce reasonable limits on the freedom and choice of the public entity.

Public contracts are essentially of three kinds:

(a) *Contracts enabling procurement of goods and/or services by a public entity* – the most prevalent form in terms of value and number of transactions. Government procurement and outsourcing is becoming the norm, given that the accent is on lean and efficient form of governance.
(b) *Contracts in the form of licenses by a public authority* – considered essential to implement "privatization" of critical sectors and resources, for example, telecom, civil aviation, and petroleum.

(c) *Contracts that govern the partnership of public and private entities* – for establishing public–private partnerships (PPPs) to develop physical or social infrastructure. This is still an emerging format and the life cycle risks and complexities are yet to be evaluated. Nonetheless, PPPs have captured the imagination of governments across the globe as a synergetic format to unlock economic growth opportunities.

It is well established that the power of judicial review is concerned with the process by which a particular decision was made, and not the merits of such a decision.[5] Hence, any executive action or decision that is illegal or based on mala fides, procedurally improper, or irrational or unreasonable will be reviewed. While there may be several, and better, suggestions to replace the decision that is being reviewed, the courts are expected to restrict themselves to only inquiring on the reasonableness of the decision actually made. To aid the judiciary in achieving this concentrated form of review, the following "enforceable measures" have been developed, interpreted and strengthened over the last few decades.

Requirement of competitive bids/auctions

In evaluating the role of government agencies in a public tender process, the judiciary has repeatedly affirmed that the following shall be the guiding principles:[6]

(a) The government is free to enter into any contract with citizens but the court may interfere where it acts arbitrarily or contrary to public interest.
(b) The government cannot arbitrarily choose any person it likes for entering into such a relationship or to discriminate between persons similarly situated.
(c) It is open to the government to reject even the highest bid at a tender where such rejection is not arbitrary or unreasonable or such rejection is in public interest for valid and good reasons.

However, do these process prudential norms require that all public contracts need to be negotiated in a process that is open for competitive bidding and public participation at all stages? Of course, the public bids will be subjected to strict conditions of eligibility, including on technical competency and financial feasibility. The following instances from the Indian context raise points to further this discussion.

Allocation of natural resources

Be it the traditional mining industry or the emerging telecom, natural gas and petroleum sectors, the voracious demand for allocation of exclusive rights to exploit natural resources has assumed a substantial proportion of value of public contracts and licenses being granted, and especially so in the Indian context. The well-established legal principle, which affirms that the public authority must adopt a transparent and fair method whenever a public contract is to be awarded, or a license to exploit natural resource is to be given, is wilting in the onslaught of such strong business currents. Between February 2012 and September 2014, the Supreme Court delivered a set of four detailed judgments that uphold and define the value of transparency and fairness in the process of allocating natural resources for economic use and exploitation.

The first of the decisions was in a PIL wherein the Supreme Court set aside the "first-come-first-served" criteria for granting telecom service licenses along with the 2G spectrum allocations,[7] and eventually ordered the cancellation of all the 122 licenses held by 8 telecom operators on the grounds of the award being illegal. This decision was constructed on the following sequence of elaborate reasoning:

(a) Citing landmark precedents, the Court invoked the doctrine of "public trust" and reiterated that the state is the trustee and caretaker of all natural resources and national assets, on behalf of the sovereign public.[8]

(b) Therefore, as natural resources are to be treated as public goods, the principle of equality is bound to govern its distribution and use. In this context, the Court then proceeded to define the two requirements of the principle of equality:

    [F]irst, it regulates the rights and obligations of the State vis-à-vis its people and demands that the people be granted equitable access to natural resources and/or its products and that they are adequately compensated for the transfer of the resource to the private domain; and second, it regulates the rights and obligations of the State vis-à-vis private parties seeking to acquire/use the resource and demands that the procedure adopted for distribution is just, non-arbitrary and transparent and that it does not discriminate between similarly placed private parties.[9] (Emphasis added)

(c) A detailed review on facts led the Court to find that the recommendations made by the Telecom Regulatory Authority of India (TRAI), were in violation of the principle of equality. It was found unreasonable that the TRAI, despite being an expert regulatory body, did not make clear and rational recommendations on issues of pricing and use of auctions. TRAI's failure was held to be responsible for subsequent violations committed by the Department of Telecommunications, since there were no well-defined guidelines to bind the decisions thereof.

(d) The "first-come-first-served" policy was severely criticized. Stating that it could have dangerous implications, it was also suggested that it necessarily promotes unholy nexus between the government officials and those wanting to profiteer. Adopting such a policy would make the entire rank and file of the government vulnerable to corrupt overtures. Collusion or any leak of vital information at any level of officials would vitiate the entire process.

In conclusion, the Court found that the entire process was arbitrary and capricious, and ordered that the process must be redone through the method of auction, which was stated to be the best method. However, on a special reference made by the President of India within a few weeks after the cancellation of licenses and the order to conduct auctions, the Supreme Court through a five-judge bench ruled that "auction which is just one of the several price recovery mechanisms, cannot be held to be the only constitutionally recognized method for alienation of natural resources."[10]

In 2012, while the issue regarding 2G spectrum allocation was being decided, the Supreme Court was approached with another PIL to declare the allocation of Coal Blocks made by the central government between 1993 and 2010 as arbitrary and illegal.[11] The main grounds of challenge, like in the matter relating to 2G spectrum allocations, was on the basis of "violation of the principle of trusteeship of natural resources by gifting away precious resources as largesse" and allegations of "arbitrariness, lack of transparency, lack of objectivity and non-application of mind." The Supreme Court declared 218 allocations of Coal Blocks, made by a screening committee of the central government between 1993 and 2011, as illegal and arbitrary. Noting the importance of maintaining the supply of coal and the enormous implication of declaring such a huge number of allocated blocks as illegal, the Supreme Court made an unusual order that the consequences of this ruling shall be considered in a separate proceeding, which was concluded within 30 days (on September 24, 2014).

This decision is a clear message being sent to the government that irrespective of serious implications and costly consequences, the Court would not be deterred from strictly examining the legal basis of executive decisions and actions undertaken over the decades. The Court clarified the correct interpretation of critical provision of the Coal Mines (Nationalization) Act, 1973, which in 1993 was amended to allow the private sector in coal mining if it is for captive use. The text of the law was clarified to mean that "the company that was applying for the coal block must have set up an iron and steel plant, power plant or cement plant and be engaged in the production of steel, power or cement." However, it was found that the Screening Committee of the Government of India had allocated coal blocks to most companies that were not engaged in production of steel, power or cement at the time of allocation. In fact, it was also observed that no declaration of such operational activity was even required in the application forms/process.

Therefore, by a simple, and accurate, reading of the law the Court held all such allocations as illegal.

Preference of "Swiss challenge" method

In 2009, the Supreme Court was required to decide on the legitimacy of the "Swiss challenge" method in public tenders. This method has gained considerable acceptance throughout the world, especially aiding in the formation of PPPs. Unlike in a traditional demand-driven exercise of announcing public tenders for specific works or requirements, a "Swiss challenge" method involves a *suo motu* proposal by any private entity (termed "original proponent") regarding development of a project/infrastructure. If the government entity finds this proposal worthy of implementation, then the public tender process is initiated on the basis of the original proponent's proposal. However, this method also involves a precondition that the original proponent is vested with a right to match the "best and final offer," and thereby enjoys the "right to first refusal."[12] Of course, one basic requirement of this method is that this condition must be clearly notified/reiterated in the "request for proposal" process and related documents and public communication.

This method has been challenged primarily on the principle that it violates the required level of fairness and transparency in awarding of public contracts. There is considerable merit in this argument. With the original proponent enjoying such overwhelming advantages, there is considerable imbalance created in the nature of equal opportunity as expected in any public tender process, thereby raising apprehensions of favoritism and cronyism. Can any private entity become an "original proponent"? *Yes*. Are there well-notified norms to evaluate such *suo motu* proposals? *No*. Is there any threshold of "innovativeness" expected of such original proposals? *No*. Are there alternative means of rewarding, or incentivizing, such original proposals? *Yes*. Are the advantages guaranteed by this method found to be reasonable and proportional? *Not evaluated*.

The Supreme Court upheld the use of this method as being "in accordance with the need of the time" and as an "encouraging concept." In addressing some of the concerns against this method of awarding public contracts and concessions, the Court mandated regulations on the following (emphasis supplied herein):[13]

(a) The state/authority shall publish in advance the nature of the Swiss Challenge Method and particulars;
(b) Publish the nature of projects that can come under such method;
(c) Mention/notify the authorities to be approached with respect to the project plans;
(d) Mention/notify the various fields of the projects that can be considered under the method;
(e) Set rules regarding time limits on the approval of the project and respective bidding;
(f) Consider the rules that are to be followed after a project has been approved by the respective authorities under the method; and
(g) Give all persons interested in such developmental activities equal and sufficient opportunity to participate in such ventures and create healthy competition among such developers.

The message in this verdict is not to discourage executive discretion in responding to the competitive needs of the day. The basic requirements – of a public bidding process and adequate information being publicized – are reiterated and upheld as the critical factors that shall continue to govern the review of any such emerging methods/policies.

Review of executive decisions

Reasoned decisions

"Speaking order" is the term used to convey the obligation of any official decision to also refer/cite the reasons for such a decision. Historically, the legal understanding was that, unless there is a mandate of the law, not every decision needs to be reasoned or "speaking" in content. However, with the administrative powers of the government being increasingly held accountable, there is a clear shift toward imposing an obligation on every decision of the government official to be adequately reasoned. Even the traditional justification of merely referring to or reiterating reports or documents or factual statements is no longer considered to be sufficient. The need for a reasoned decision has now been elevated to being a "principle of natural justice."

The courts have been consistent in holding that all decisions of the government, which amount to any form of benefit being conferred on private parties, need to be communicated in a reasoned order. There cannot be any advantage granted, or disadvantage caused, without a proper examination of the facts and with explanatory reasons for such a finding.

There has been considerable discussion on what category of decisions of the government would need to meet this onerous requirement. The judiciary's response has been to classify certain administrative functions as being *quasi-judicial* in nature. This entails an obligation to follow all basic principles of natural justice, akin to a purely judicial task. While this may appear burdensome, even repetitive, the expectation of fairness demands that each decision of the government, or its determination, must be accompanied with cogent reasons. This would effectively rule out any speculation on the grounds for the decision, and also facilitate an informed review of the decision, if appealed to, or reviewed by, higher authorities.

Furthermore, under the Indian Constitution, right to freedom of trade and occupation is a fundamental right of all citizens. Therefore, if an application for a license or a tender bid is rejected without any proper record of reasons, it can be challenged not only for being arbitrary, but also as an unreasonable denial of fundamental rights.[14]

Bias or conflict of interest

Executive powers, prerogatives and decisions, form the backbone of the governance structures in a democracy. The ability of government functionaries to implement policies and projects for the welfare of the public is enabled by such conferment of privileges. The courts have subjected these privileges of the government officials to a higher threshold of accountability by terming them as *quasi-judicial*. Way back in 1969 itself, the Supreme Court has held that

> the requirement of acting judicially in essence is nothing but a requirement to act justly and fairly and not arbitrarily or capriciously. The procedures which are considered inherent in the exercise of a judicial power are merely those which facilitate if not ensure a just and fair decision. In recent years the concept of quasi-judicial power has been undergoing a radical change. What was considered as an administrative power some years back is now being considered as a quasi-judicial power.[15]

Administrative decisions are evaluated for fairness on the basis of this exalted status. The popular adage that "justice should not only be done; but appear to have been done" assumes significance. The principles of natural justice, a collective conception of especially common-law legal systems to determine fairness in administrative or judicial functions, require the executive not only to be unbiased, but to also not give rise to apprehensions of bias. This is a standard that has evolved over the years as applicable to a judge. A judge in India, either of the Supreme Court or of the High Court, can be removed only by an impeachment motion passed by a joint sitting of the Parliament, the implication being that a judge has to be of unimpeachable integrity and conduct oneself in that manner. Of course, it is a different issue that no judge has been impeached till date in India. The legislative procedure of doing so has been deliberately kept very elaborate and long drawn so as to assure judicial independence. In all cases of impeachment motion being taken up for discussion by the Parliament, the concerned judges have tendered their resignation during the pendency of the process.

This standard of being unbiased and impartial is now being extended to a bureaucrat and a politically appointed minister as well.

Role of monitoring

In *Vineet Narain* v. *Union of India*,[16] a PIL before the Supreme Court was filed complaining against the lack of promptitude by the CBI (Central Bureau of Investigation) in matters involving accusations of economic crimes against high dignitaries. The issue was whether it is within the domain of judicial review to supervise and direct the investigative process which is otherwise under the administrative control of the political executive. The Court held that it found it necessary to direct "the CBI not to report the progress of the investigations to the person occupying the highest office in the political executive" (alluding to the prime minister) and that this was being done to eliminate "any impression of bias or lack of fairness or objectivity and to maintain the credibility of the investigations." It was, therefore, decided to direct the CBI and other agencies to complete the investigation expeditiously, keeping the Court informed from time to time of the progress of the investigation. An innovative procedure adopted is termed *continuing mandamus*, whereby the writ of mandamus (a judicial command to an authority to perform the mandated duty) is applicable for an uninterrupted and unstipulated period of time for preventing any miscarriage of justice.

We must appreciate the innovative step of the Court in taking over the reins of supervising the investigations by the CBI. The politico-bureaucratic nexus evident in this matter led the Court to explore such creative remedies.

"Negligence" in economic governance and related decision-making

Bureaucrats and service conditions

Law is widely evaluated by its ability to make a difference in the society and by its ability to reflect the aspirations of the people who are governed by it. Justice is essentially the judiciary meeting the public expectation of sound execution of the law. Oliver Wendell Holmes referred to law as "prophecies of what the courts will do in fact, and nothing more pretentious."[17] This is what motivates the court in a common-law legal system. The real and common concerns of the society need to be identified and redressed, if not by the law – as it is legislated; or in the manner it is executed – then by its interpretation. The Supreme Court, in 1955, had remarked: "It may not be possible to frame an exhaustive definition of what executive function means and implies. Ordinarily the executive power connotes the residue of governmental functions that remain after legislative and judicial functions are taken away."[18] Indian judiciary has certainly taken firm steps toward imposing strong ethical norms in administration, and thereby, making the bureaucrat more accountable.

Ethical framework

Section 197 of the Code of Criminal Procedure, 1973, provides for a safeguard against public servants from being prosecuted for any crimes directly. It relevantly states, "When any person who is or was . . . a public servant . . . is accused of any offence alleged to have been committed by him while acting or purporting to act in the discharge of his official duty, no Court shall take cognizance of such offence except with the previous sanction" of the central or the state government as the case may be. This provision, a vestige of the British code of legislations, is heavily criticized and there has been public outcry against such immunity. While it may appear to be a matter of mere procedure, in reality it has resulted in an excellent tool for a corrupt system or Department to safeguard a member of its own. This is also because the sanction needs to be given by the "competent authority," who is usually the superior officer who has the power to appoint/dismiss the person against whom the criminal prosecution is being sought.

The Supreme Court has whittled this provision down considerably in the last few years. Most recently, the Court explained the rationale for such a safeguard in the law and as to why it needs to be interpreted strictly and stated that

> [t]he principle of immunity protects all acts which the public servant has to perform in the exercise of the functions of the Government. The purpose for which they are performed protects these acts from criminal prosecution. However, there is an exception. Where a criminal act is performed under the color of authority but which in reality is for the public servant's own pleasure or benefit then such acts shall not be protected under the doctrine of State immunity.[19]

In another matter that had attracted considerable public and media attention, since it challenged the then prime minister of holding back on sanction to prosecute the then telecom minister on charges of corruption, the Court held that:

> [p]ublic servants are treated as a special class of persons enjoying the said protection so that they can perform their duties without fear and favor and without threats of malicious prosecution. However, the said protection against malicious prosecution which was extended in public interest cannot become a shield to protect corrupt officials. These provisions being exceptions to the equality provision of Article 14 are analogous to the provisions of protective discrimination and these protections must be construed very narrowly. These procedural provisions relating to sanction must be construed in such a manner as to advance the causes of honesty and justice and good governance as opposed to escalation of corruption.[20]

There is a need to protect and safeguard government officers and ministers who serve the public cause and take steps without any fear or favor. However, if the shield is being used more often to protect those against whom there are allegations of serious crimes, then it needs to be revisited. The present stance of the Court is that this requirement of sanction is to be time bound. If there is no response for three months, then it shall be deemed as sanctioned. If there is a rejection, then the same will have to be based on sound reasons, and would certainly be subject to further appeals/review by the Court.

Fixed tenure

A weak element of the Indian bureaucracy has been the bane of transfers and its enormous contribution to corruption, by itself and as a causal factor. Frequent shifting of honest and sincere officers has led to widespread disenchantment within the rank and file of the bureaucracy. The power of transfer is wielded as a threat by the political masters of service personnel. For any allegation of premature or ill-advised or motivated transfers, there is a standard justification of "routine" shuffling of officers. While there could be administrative exigencies for each position, a reasonable tenure is invaluable and non-negotiable. Security of a fixed term shall not only make the officer fearless, but would also provide sufficient time and opportunity to perform in a particular position.

In a matter regarding the leadership of a special court being considered, the Supreme Court has held that

> unless the term of office is fixed as at least five years with a provision for renewal (or re-appointment), except in cases of incapacity, misconduct and the like, the constitution of the Tribunal cannot be regarded as satisfying the essential requirements of an independent and impartial body exercising judicial functions of the state.[21]

Given the complexity and the enduring nature of administrative functions, it would help to apply the same yardstick to today's bureaucracy and a fixed tenure of three to five years is mandated, thereby enabling greater stability and continuity in the regulations.

Furthermore, the protection of the salaries and related terms of privileges from any negative interference is also to be viewed as an important factor that guarantees the fairness and unbiased role of the bureaucracy. The Constitution does safeguard the process of removal of any bureaucrat (in Article 311), though it needs to also be rigorously enforced and on sound grounds so as to eschew any scope for abuse or for wrong judgment.

Minister's "policy": instructions

In India, the existence and role of the cabinet is based on conventions of the "Westminster" model. The Indian Constitution only provides for a council of ministers, led by either the prime minister of the union or the chief minister in the state. However, the actual power exercised by this collective of cabinet ministers is enormous. It would not be incorrect to state that on the one hand the cabinet controls the legislative agenda of the Parliament and on the other drives the bureaucracy to implement political/populist measures.

What would be the legal implication if an official is constrained to decide in a particular manner owing to binding "policy instructions" issued by the cabinet? Would the official's decision be invalid on the grounds of "non-application of mind"? To reiterate, power of judicial review is to test the impugned decisions on the basis of their reasonableness and the extent of "application of mind": by the entity that was entrusted with the task. Terming such decisions as that of a "*closed mind*," a few courts in England have held that such decisions may be struck down on the grounds that the outcome is predetermined, whether by the adoption of an inflexible policy or by the effective surrender of the authority's independent judgment.[22]

It is reasonable to argue that periodic "policy instructions" are required toward effective goal setting. Given that authorities are forced to rely on technicalities and mechanisms, they may lack the ability to understand the broader socio-economic and political ramifications of their decisions. Administration of any public welfare-based services necessarily involves adopting a citizen-centric approach, thereby justifying the need to be constantly guided by the priorities as determined by democratically elected representatives. Even while accepting this to be a true assessment, it is nonetheless to be noted that the mandatory nature of such "policy instructions" significantly dilutes the independence of the bureaucrat.

The integral role played by the political executive in the policymaking process cannot be discounted. Beginning with the manifesto at the time of elections, the political entities upon assuming power usually seek to dominate the policy space with populism laced with certain ideological predilections. While it may be justifiable to concede this policy space to the democratically elected representatives, none of the administrative objectives shall be achieved if there is political interference in the functioning of the bureaucrats. While there could be interference by the ministers on a day-to-day basis, what could pose a greater hindrance is if the policies and executive actions are determined on the basis of political viewpoints and popular appeal. Therefore, it is entirely possible that the government, being compelled to appease its political constituency, issues "policy instructions" that are not borne out of any independent or unbiased judgment of the authority. This would make the entire edifice of administrative machinery vulnerable to vested interests and cronyism.

Of course, if the same content of "policy instructions," even if bearing a political motive, are imposed either as a law through the legislature, or are promulgated as ministerial/departmental notifications in exercise of power of delegated legislation, then it would, and should, be binding in nature.

Remedies against administrative negligence

In the business world, be it in selling goods or services, a reasonable "duty to take care" is being set as a benchmark for adjudging the likelihood of any form of liability owed to consumers. While industry-level standards are common, they are only informative indicators of levels of quality of a product. The courts in common-law countries are giving an expansive interpretation to the tortious forms of liability (i.e., a liability arising out of "tort" or wrong). It is essentially a liability for "carelessness" or negligence. In the context of goods and services, negligence is viewed as an affront by the manufacturer/service provider against the hapless consumer. Any violation of a reasonable "duty to take care" is determined as negligence, and the entity committing the wrong is obligated to compensate (monetarily) any loss arising out of such negligent act. Over a considerable period of time, common-law courts have evolved a strong basis for tortious liability if there is any breach in the *fiduciary* obligations. The legal understanding of obligations of fiduciary nature is that they signify high degrees of entrustment, and thereby require a far greater standard of care to be exercised. Common examples of such fiduciary relations are those of doctor–patient, attorney–client; and insurer–customer–beneficiary. The board of directors is also bound in fiduciary capacity to the corporation.

Similarly, it is being suggested that even bureaucrats and public servants must be recognized as trustees of the citizens. Therefore, the actions of the public servants must also be subjected to a reasonable "duty to take care." In England, all ministers and public servants of the Crown are held accountable to the courts for the legality of their actions. In addition to their decisions being subject to judicial review by the courts (as explained in the previous section), they could also face personal liability of civil (tortious) and criminal nature.

There are challenges relating to imposition of criminal remedies and resulting punishments (like penalties, fines, forfeiture of property, and imprisonment). However, these challenges are more systemic in nature. We need to have competent investigators and prosecutors to effectively, and promptly, address the complex nature of organized economic and corporate crimes of today. With respect to classification of what actions/omissions would amount to being a crime, there is reasonable amount of certainty. Any violation of the law or an act of corruption would result in the concerned person committing a crime and facing prosecution. There would be concerns of collecting enough evidence to prove the crime in any given matter, but as to whether the alleged act in itself should be considered a crime is not debated.

Tortious principles and remedies have always raised concerns of being subjective and ambiguous. The principle of *sovereign immunity* was developed only to redirect the uncodified surge of tortious remedies toward establishing consumer rights, in the sphere of private businesses. However, today's democracies thrive on citizen-centric and participatory rights. Sovereign immunity as a concept is losing sheen and has been reduced to safeguard only such activities that are truly and traditionally "sovereign" in nature – defense, administration of justice, functions of law and order, and foreign affairs.[23] With the steady demise of the concept of sovereign immunity, there is also strengthening of the counter-principles that have emerged to demand greater accountability and continuity in governance, policies and decisions, namely – *promissory estoppel* and *legitimate expectations*. However, these principles are effective against the government as a whole. They do not pursue personal/individual liability of government functionaries.

Originating primarily from the English law, and now being applied across the commonwealth nations including, Australia, New Zealand and Canada, tortious liability for "misfeasance in public office" is emerging as a principle of administrative law. Halsbury's Law of England, an encyclopedic resource on definition and latest interpretation of legal concepts, states:

> Deliberate abuse of public office or authority; (or) Bad faith on the part of a public officer or authority; will result in civil liability where the act would constitute a tort but for the presence of statutory authorization, as parliament intends statutory powers to be exercised in good faith and for the purpose for which they were conferred. There exists an independent tort of misfeasance by a public officer or authority which consists in the infliction of loss by the deliberate abuse of a statutory power, or by the usurpation of a power which the officer or authority knows he does not possess, for example by procuring the making of a compulsory purchase order, or by refusing, or cancelling or procuring the cancellation of a licence, from improper motives. However, where there has been no misfeasance, the fact that a public officer or authority makes an ultra vires order or invalidly exercises statutory powers will not of itself [be] found an action for damages.[24]

In 1996, the Supreme Court made a bold move and asked a union minister to pay an exemplary penalty (of Rs. 50 lakh) in a matter wherein the minister's actions in allocating discretionary quota of petrol pump stations were found to be arbitrary.[25] The Court went further and directed the CBI to file a case and investigate all the allocations and beneficiaries for possible instances of corruption.

The Court justified its strict stance on the grounds that

> [a] Minister who is the executive head of the department concerned distributes these benefits and largesses. He is elected by the people and is elevated to a position where he holds- a trust on behalf of the people. He has to deal with the people's property in a fair and just manner. He cannot commit breach of the trust reposed in him by the people. We have no hesitation in holding that Capt. Satish Sharma in his capacity as a Minister for Petroleum and Natural Gas deliberately acted in a wholly arbitrary and unjust manner. We have no doubt in our mind that Capt. Satish Sharma knew that the allottees were relations of his personal staff, sons of Ministers, sons/relations of Chairman and members of the Oil Selection Boards and the members of the Oil Selection Boards themselves. The allotments made by him were wholly mala fide and as such cannot be sustained.

Subsequently, in 1999, this decision of imposing exemplary penalty was reviewed by another set of judges of the Supreme Court and it was set aside.[26] The direction to the CBI was also set aside. However, it must be noted that this finding was based mainly on facts, and the Court reiterated that they agree with the principle of imposing personal liability for "misfeasance in public office."

While the extent of such personal liability may be debatable, it is gradually coming to be established that working for the government would no longer mean immunity from litigations and liability – either in the form of compensation or, in extreme instances, even punishments like forfeiture of property and incarceration.

Notes

1 This principle was first formulated in – *Associated Provincial Picture Houses, Limited* v. *Wednesbury Corporation* [1947] EWCA Civ 1 – a decision rendered by the King's Bench of the Court of Appeal of England and Wales in November 1947. It has now come to be the defining basis of judicial review of executive actions (decisions of the government) across legal systems.

2 This part is drawn mainly from: Anil B. Suraj, "*Public Interest in Globalization: Role of the Judiciary in India*," a paper presented at the International Seminar on Public Interest Litigation and Globalization, organized by the Institute of Human Rights, at Colombo, Sri Lanka, March 10–12, 2006; and Anil B. Suraj, "*Citizen-centric Orientation in Regulatory Governance*," part of the submissions

made to the Second Administrative Reforms Commission, Government of India, in March 2008.

3 Most notably in the matter of *S.P. Gupta* v. *Union of India* (1982).

4 This term is used by the Government of the UK in the proposed *Public Contracts Regulations 2015*. The definition is similar to the understanding of "state" under Article 12 of the Indian Constitution and identifies the determinable factors to include – general and public interest orientation; majority state funding; and management and supervision by public authorities.

5 For a detailed discussion on this theme refer: Chiranjib Sen and Anil B. Suraj, *The Role of Legal Process in the Redesign of Indian Government-Business Relations*, Working Paper #102, the Center on Democracy, Development and the Rule of Law, Freeman Spogli Institute of International Studies, Stanford University, CA, October 2009, at http://iisdb.stanford.edu/pubs/22692/No_102_SenSuraj_Legal_Process_India_91909.pdf (last visited on June 28, 2015).

6 These consistent principles guiding judicial review of public tender process were quoted in *Ravi Development* v. *Shree Krishna Prathisthan and Others* [AIR 2009 SC 2519] at para. 13.

7 *Centre for Public Interest Litigation and Others* v. *Union of India* [Supreme Court decision dated February 2, 2012].

8 Relevant references of the Supreme Court in this regard: *Secretary, Ministry of Information & Broadcasting, Govt. of India* v. *Cricket Association of Bengal* (1995)2 SCC 161 – wherein it was held that airwaves/frequencies are public property and they have to be "used in the best interest of the society," even after they are licensed to private agencies. *M.C. Mehta* v. *Kamal Nath* (1997)1 SCC 388 – this doctrine was specifically identified and held that it is "the duty of the Government to provide complete protection to the natural resources as a trustee of the people at large."

9 Quoting and reiterating a past decision in the matter of land allocation, the Court further stated: "*The distribution of largesse like allotment of land, grant of quota, permit licence, etc. by the State and its agencies/instrumentalities should always be done in a fair and equitable manner and the element of favouritism or nepotism shall not influence the exercise of discretion, if any, conferred upon the particular functionary or officer of the State* [emphasis added]." *Akhil Bharatiya Upbhokta Congress* v. *State of M.P.* (2011) 5 SCC 29.

10 *Re: Special Reference* No.1 of 2012 – [Supreme Court opinion dated September 27, 2012].

11 *Manohar Lal Sharma* v. *The Principal Secretary, Ministry of Coal & Others* – [Supreme Court decision dated August 25, 2014].

12 In some variations of this method, the requirement to match the best offer may be softened by allowing a favorable gap of 5–10%. Therefore, the contract stands awarded to the original proponent if its bid is within the range of 5–10% of the best offer.

13 *Supra*, n. 6, at para. 30.

14 S. P. Sathe, *Administrative Law* (Seventh Edition, New Delhi: Lexis-Nexis Butterworths, 2004), at p. 170.

15 *A. K. Kraipak and Others* v. *Union of India* – (1969)2 SCC 262.

16 AIR 1998 SC 889.

17 Oliver Wendell Holmes, "The Path of Law," in *Collected Legal Papers* (New York: Harcourt, Brace and Howe, 1920), 167–202, at p. 173. Justice Holmes, who

advocated "judicial restraint," is hailed as a constitutional jurist for his various judgments and opinions given during his 30-year tenure (1902–1932) as a justice of the US Supreme Court.

18 *Rai Sahib Ram Jawaya Kapur* v. *State of Punjab* – [1955]2 SCR 225.
19 *Inspector of Police* v. *Battenapatla Venkata Ratnam and Others* (Supreme Court decision dated April 13, 2015).
20 *Subramanyan Swamy* v. *Manmohan Singh* (2012)3 SCC 64.
21 *Madras Bar Association* v. *Union of India* – Supreme Court [Civil Appeal Nos. 3067 of 2004 and 3717 of 2005, decided on May 11, 2010]. This viewpoint was reiterated by the Supreme Court in the context of proposed civil service reforms in *T.S.R. Subramanian & Others* v. *Union of India* (decided on October 31, 2013).
22 In a PIL seeking wide-ranging civil service reforms, *T.S.R. Subramanian & Others* v. *Union of India* (decided on October 31, 2013), the Supreme Court quoted the Second Administrative Reforms Commission thus – "*an impartial civil service is responsible not only to the government of the day but to the Constitution of the land to which they have taken an oath of loyalty. At the same time, implementing the policies of the duly elected government is a core function of civil servants. That is why the division of responsibility between the civil servants and ministers needs to be more clearly defined. A framework in which responsibility and accountability is well defined would be useful* [emphasis added]."
23 *Liability of the State in Tort*, the First Report of the Law Commission of India (1956) – "The old distinction between sovereign and non-sovereign functions or governmental and non-governmental functions should no longer be invoked to determine the liability of the State."
24 *Halsbury's Laws of England*, Vol. 1(1), 4th Edition (Re-issue), para. 203.
25 *Common Cause* v. *Union of India* (1996)6 SCC 530.
26 *Common Cause* v. *Union of India* (1999)6 SCC 667.

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