AN ABSTRACT

ECONOMIC SURVEY 2020

BRIEF SUMMARY: CHAPTER 1 - PART 2

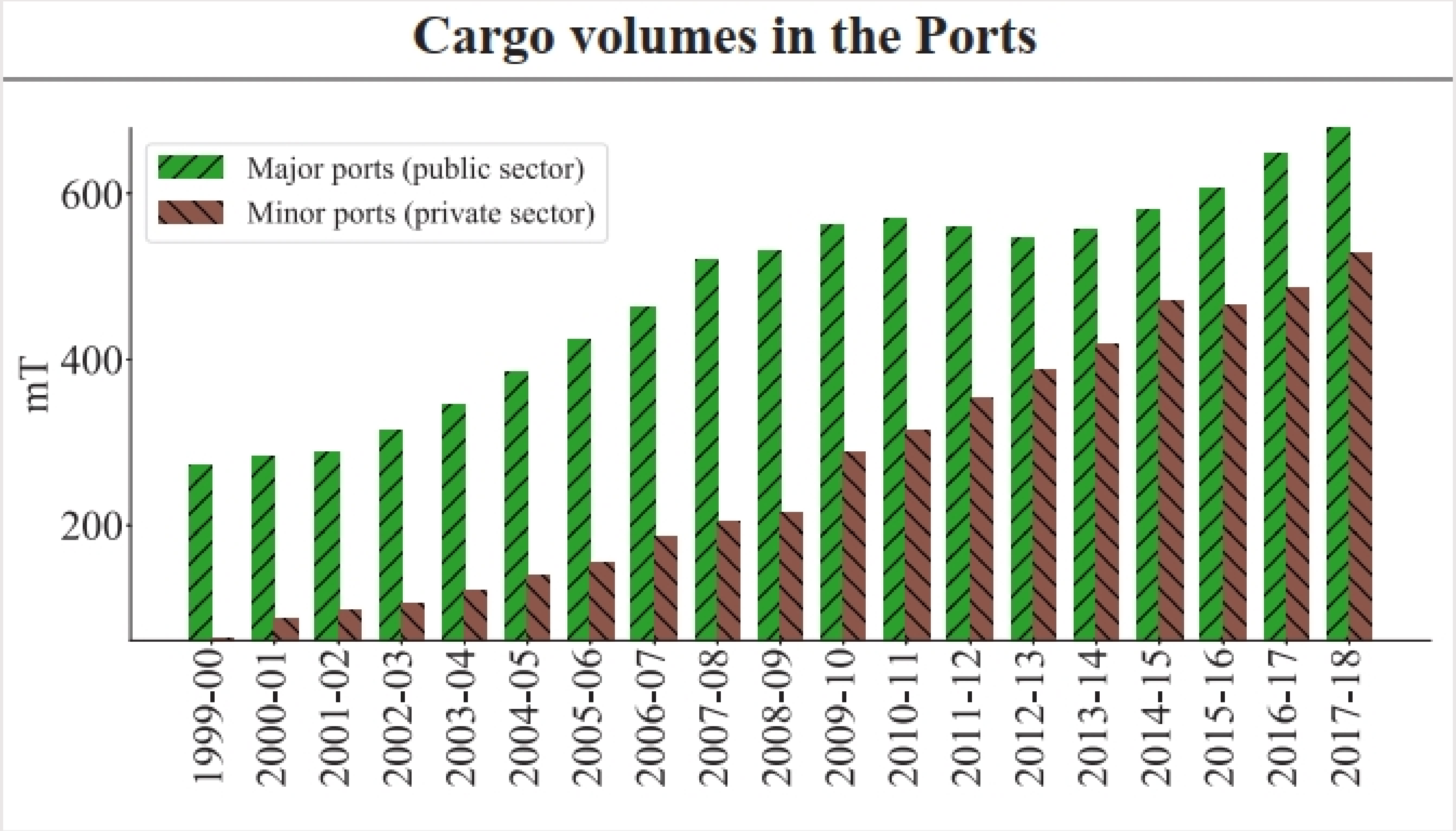
WEALTH CREATION: THE INVISIBLE HAND SUPPORTED BY THE HAND OF TRUST

drishti

Wealth Creation:

1. Our age-old traditions have always commended wealth creation. While Kautilya's Arthashastra is given as a canonical example, wealth creation as a worthy human pursuit is recognised by other traditional literature as well.
2. In the second part of the Thirukural, the essence of material wealth is declared: "**Make money – there is no weapon sharper than it to sever the pride of your foes.**"
3. Needless to say, Thirukural advocates wealth creation through ethical means - "**(Wealth) yields righteousness and joy, the wealth acquired capably without causing any harm.**"
4. The country has historically been a major wealth creator and a significant contributor to world's GDP.
5. Despite such a "rich" tradition of emphasizing wealth creation, India deviated from this model for several decades after independence. However, India returned back to these roots post economic liberalisation in 1991.
6. **The exponential rise in India's GDP and GDP per capita post liberalisation coincides with wealth generation in the stock market.**
7. To understand the benefits from wealth creation, the Economic Survey collated the companies created by top 100 wealthy entrepreneurs in the country as estimated by Forbes in March 2019. Further, the Survey correlated the increase in the entrepreneur's wealth over a decade (31-Mar-2009 to 31-Mar-2019) with the benefits that accrued to several other stakeholders including employees, suppliers, government, etc.

8. **Wealth created by an entrepreneur correlates strongly with raw materials procured by the entrepreneur's firms,** which proxies the benefits that suppliers reap by supplying raw materials to the entrepreneur's firms. **Wealth created by an entrepreneur also correlates strongly with the capital expenditures made by the entrepreneur's firms,** which proxies the benefits that manufacturers of capital equipment reap by supplying such equipment to the entrepreneur's firms.



Foreign Exchange Revenue:

1. **Revenues earned in foreign exchange enable macroeconomic stability by enabling the country to pay for its imports and keeping the current account deficit at manageable levels.**
2. Wealth creation by entrepreneurs correlates strongly with the foreign exchange revenues earned by the entrepreneurs' firms.
3. Wealth created by an entrepreneur also helps the country's common citizens. Tax revenues enable Government spending on creating public goods and providing welfare benefits to the citizens. **There is a strong correlation between wealth creation by entrepreneurs to the taxes paid to the Government.**

Figure 2a: India's GDP (current US$ tn) (1960-2018)

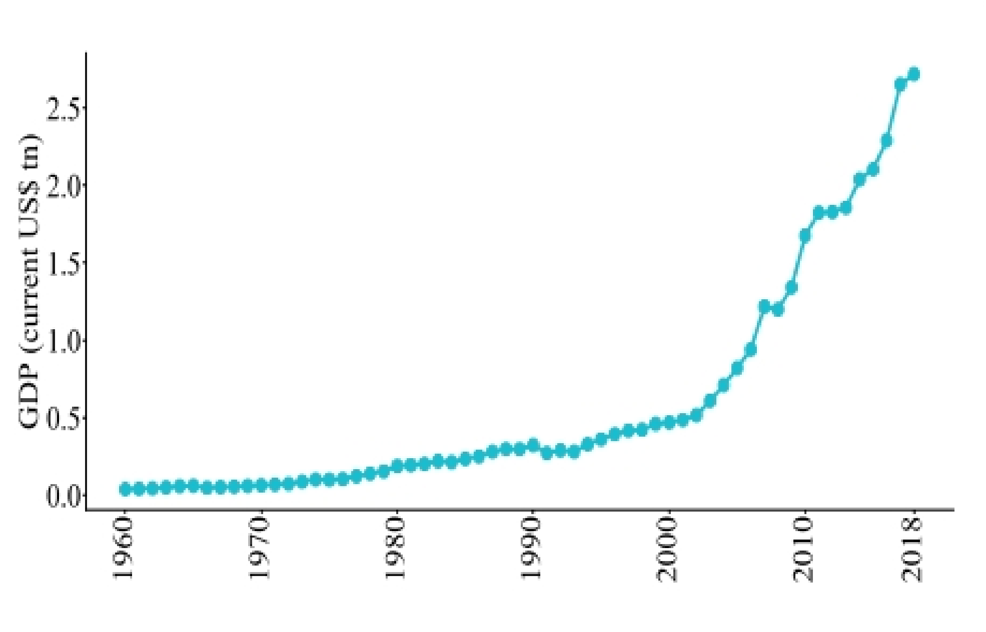
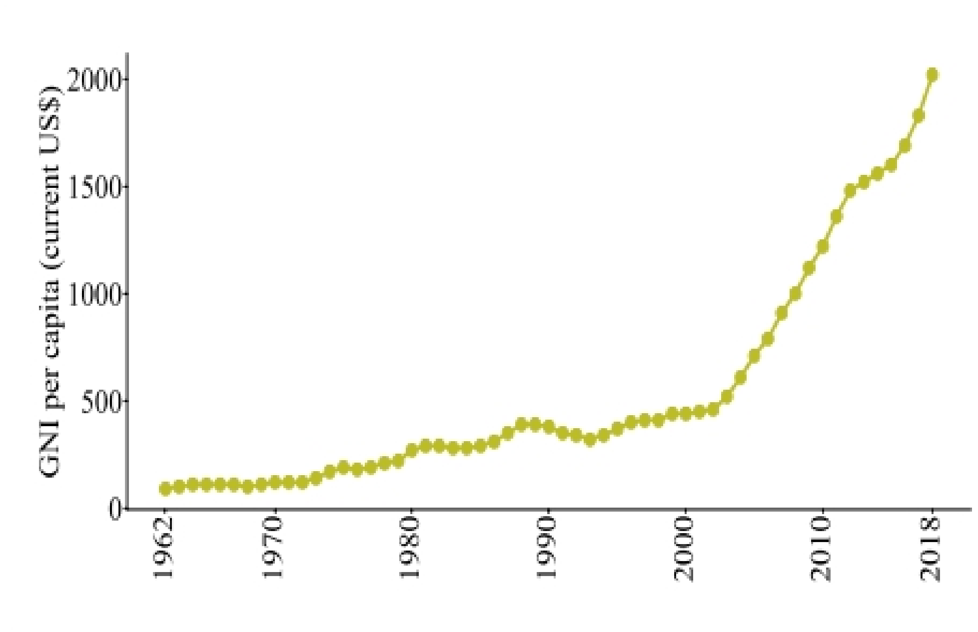


Figure 2b: India's GDP per capita (current US$) (1960-2018)



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The Invisible Hand Of Markets:

1. The Economic Survey has emphasised the role of the invisible hand in wealth creation and economic development as postulated by Adam Smith. **Wealth creation and economic development in several advanced economies has been guided by this philosophy of Adam Smith's.**
2. Despite the dalliance with socialism – four decades is but an ephemeral (transient) period in a history of millennia – India has embraced the market model that represents our traditional legacy. In fact, **our traditional economic thinking has always emphasized enabling markets and eliminating obstacles to economic activity.**
3. As per Kautilya, "The root of wealth is economic activity and lack of it brings material distress. In the absence of fruitful economic activity, both current prosperity and future growth are in danger of destruction. A king can achieve the desired objectives and abundance of riches by undertaking productive economic activity". Kautilya advocates economic freedom by asking the King to "remove all obstructions to economic activity".
4. **During much of India's economic dominance, the economy relied on the invisible hand of the market.**

Contributors to ancient India's wealth:

1. A key contributor to ancient India's prosperity was internal and external trade.
2. Two major highways **Uttarapatha** (the Northern Road) and **Dakshinapatha** (the Southern Road) and its subsidiary roads connected the sub-continent.

3. Meanwhile, ports along India's long coastline traded with Egypt, Rome, Greece, Persia and the Arabs to the west, and with China, Japan and South East Asia to the east.
4. **Much of this trade was carried out by large corporatized guilds akin to today's multinationals** and were funded by temple-banks.5. Thus, commerce and the pursuit of prosperity is an intrinsic part of Indian civilizational ethos.

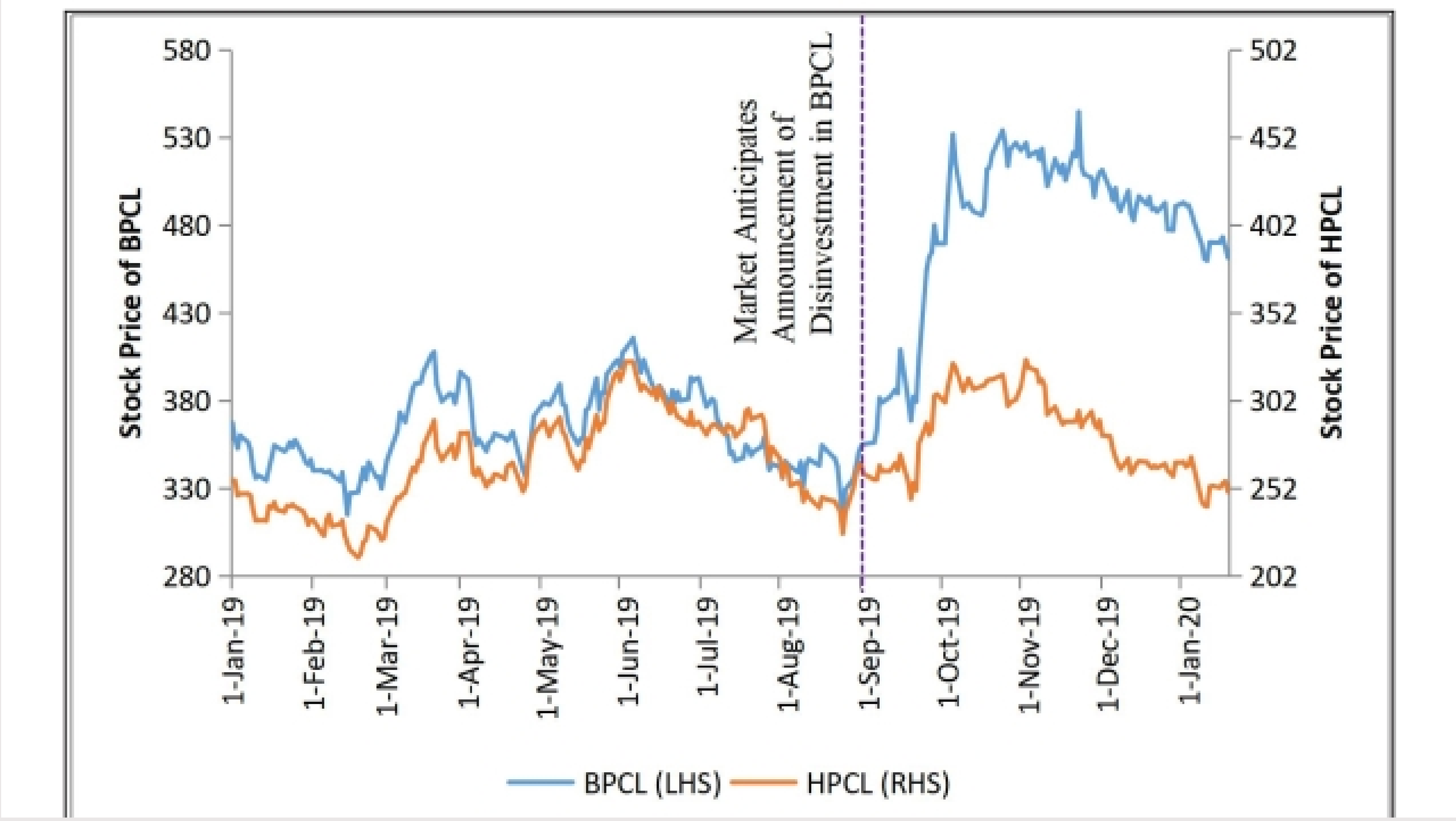
Instruments For Wealth Creation:

- **Enhancing efficiency is crucial for wealth creation.** A key dimension of efficiency pertains to opportunity.
- **Equal opportunity for new entrants is important** because, as the survey shows, a 10 per cent increase in new firms in a district yields a 1.8 per cent increase in Gross Domestic District Product (GDDP). This effect manifests consistently both across districts and across regions.
- **A key dimension of opportunity pertains to that between new entrants and incumbents.** While incumbents are likely to be powerful, influential, and have a voice that is heard in the corridors of power, new entrants are unlikely to possess these advantages. Yet, new entrants bring path-breaking ideas and innovation that not only help the economy directly but also indirectly by keeping the incumbents on their toes. Therefore, the vibrancy of economic opportunities is defined by the extent to which the economy enables fair competition, which corresponds to a "pro-business" economy.

- **The freedom to choose is best expressed in an economy through the market** where buyers and sellers come together and strike a bargain via a price mechanism. Where scarcity prevails and choice between one use of scarce resources and another must be made, the market offers the best mechanism to resolve the choice among competing opportunities. **This principle is fundamental to a market economy.**
- **The command and control approach contends that the price of a good should be regulated.** Our economy still has some of the regulatory relics of the pre-liberalisation era. The survey provides evidence that **government intervention hurts more than it helps** in the efficient functioning of markets. For instance, in the pharmaceutical industry, government regulated formulation prices increase more than unregulated formulations. Moreover, the supply of unregulated formulations is more than that of regulated formulations.
- The Survey finds that **unshackling the economic freedom for markets augments wealth creation.**
- **Yet another dimension of efficiency concerns allocation of resources to ensure their optimal use.** Since resources are limited, a nation has to make choices. For example, given its demographic dividend, should India focus on labour-intensive industries or on capital intensive industries?
- **An efficient financial sector is extremely crucial for enhancing efficiency in the economy.** Historically, in the last 50 years, the top-five economies have always been ably supported by their banks. The support of the U.S. Banking system in making the U.S. an economic superpower is well documented.

- In recent times, as China has emerged as an economic superpower, it has been ably supported by its banks—**the top four largest banks globally are all Chinese banks.** The largest bank in the world—Industrial and Commercial Bank of China—is nearly two times as big as the 5th or 6th largest bank, which are Japanese and American banks respectively.
- **As PSBs account for 70 per cent of the market share in Indian banking, the onus of supporting the Indian economy and fostering its economic development falls on them.** Yet, on every performance parameter, PSBs are inefficient compared to their peer groups.

Figure 17: Comparison of Stock Prices of BPCL and HPCL



Trust As A Public Good:

1. In a **market economy too, there is need for state to ensure a moral hand to support the invisible hand.**
2. As Sandel (2012) argues, **markets are liable to debase ethics in the pursuit of profits at all cost.**
3. Trust contributes positively to access of both formal and informal financing.
4. Ancient philosophers consider trust as an important element in a society and postulated that trust can be furthered by appealing to ethical and philosophical dimensions.
5. Along these lines, the Survey introduces "**trust as a public good that gets enhanced with greater use**".
6. Philosophers such as Aristotle and Confucius (implicitly) also viewed trust as a public good by explaining that "**good laws make good citizens.**"
7. In the contemporary context, the Global Financial Crisis represented a glaring instance of the failure of trust in a market economy.

Conclusion:

The survey posits that India's aspiration to become a $5 trillion economy depends critically on strengthening the invisible hand of markets and supporting it with the hand of trust. The invisible hand needs to be strengthened by promoting pro-business policies to:

(i) provide **equal** opportunities for new entrants, enable fair competition and ease doing business,

(ii) **eliminate** policies that unnecessarily undermine markets through government intervention,

(iii) enable trade for **job** creation, and

(iv) efficiently scale up the **banking** sector to be proportionate to the size of the Indian economy.

Introducing the idea of “trust as a public good that gets enhanced with greater use”, the Survey suggests that **policies must empower transparency and effective enforcement using data and technology to enhance this public good.**

This was the summary for Chapter 1 Part 2, we will share the next summary soon.