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Tackling Inflation and Unemployment in India

Student Research Internship Report

Agnivo Sarkar

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Introduction:

Inflation is defined to be a condition of persistent rise in the general level of prices. In an inflationary situation, the general trend of prices is upwards. This is statistically captured by the persistent upward movement of some aggregate price index, usually WPI (Wholesale Price Index) or CPI (Consumer Price Index) or GDP deflator. Well, this is what it says on all the textbooks about inflation but in reality, Inflation is a "necessary evil- no one likes it but it is needed for economic growth"- You can't live with it, you can't live without it.

Indians have become more and more worried about the inflation rate. In May 2021, retail inflation, which is measured by using the Consumer Price Index, came in at 6.3% — that is 30 basis points (0.3 percentage points) above the highest level of inflation that RBI targets.

Official data tells us that WPI-linked inflation went from 7.4% in March to 10.5% year-on-year in April 2021, touching double-digits for the first time since 2010.

Inflation and unemployment are related economic problems. A theoretical construct, the Phillips Curve, articulates a trade-off between inflation and unemployment rates, states that the two are inversely related in the short run. This hypothesis has opened up a possible policy tool for governments by which they could use an unemployment buffer to control inflation. Under a mainstream Non-Accelerating Inflation Rate of Unemployment (NAIRU) regime, inflation is controlled using tight monetary and fiscal policy, which leads to a buffer stock of unemployment. This is a very costly and unreliable target for policy makers to pursue as a means for inflation proofing.

An MMT perspective:

Bill Mitchell, one of the founders of the Modern Monetary Theory (MMT), said in one of his works that, "unemployment is always a greater problem than inflation in almost any dimension you want to define it", for which the Modern Monetary Theory has received a lot of criticism saying MMT lacks a concern for inflation, although MMT argues for price stability, which is needed because it keeps the value of money stable, eliminates economic fluctuations, brings stability in the economy, checks arbitrary redistribution of income and wealth and promotes economic welfare.

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[1] BA Economics, St. Xavier's University, Kolkata.
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MMT advances Employment buffer stocks, where the government exploits the fiscal power embodied in a fiat-currency issuing national government to introduce full employment based on an employment buffer stock approach. The Job Guarantee (JG) model which is central to MMT is an example of such an approach. The JG scheme absorbs workers displaced from private sector, creating a buffer employment stock and pays them the minimum market wage.
As per the works of Bill Mitchell, he called the ratio of JG employment to total employment the Buffer Employment Ratio (BER). When the BER is high, real wage demands will be correspondingly lower. If inflation exceeds the government's announced target, tighter fiscal and monetary policy would be triggered to increase the BER, which entails workers transferring from the inflating sector to the fixed price JG sector. The BER that results in stable inflation is called the Non-Accelerating-Inflation-Buffer Employment Ratio (NAIBER).

The Mahatma Gandhi National Rural Employment Guarantee Act (MGNREGA) is an example of such Job Guarantee scheme implemented in India by the UPA government under Prime Minister Dr. Manmohan Singh, in September 2005. The MGNREGA scheme is only applicable across rural India at the moment. Under the scheme, the government guarantees 100 days of employment in a financial year to each household located in rural areas.

Aftermath of the Pandemic:

The corona virus pandemic which burst out in 2020 led to severe economic downturn and affected the livelihood of many people. The participation rate went down to 39.6% from nearly 43% with a dip of more than 3%. A low labour force participation rate undermines a country's overall productivity and wellbeing because fewer people are making themselves available for economic activity.

Unemployment in India stood around 7.2% before the pandemic and currently stands at about 9.2%, being the highest compared to other Asian countries, despite of having an already poor participation rate. In other words, even when only about 40 out of every 100 Indians in the working-age group look for a job, our economy still is unable to create jobs for them. Also, data shows that the total employment has gone down by 5% from what it was before the pandemic, implying, instead of creating jobs, the economy has extinguished close to 22 million jobs. The only way to come out of this is increased government direct spending on job creation, in particular, on MGNREGA - with a possible extension to urban employment too.

The survey conducted as part of the study by the London School of Economics, quoted in a Bloomberg News report, suggests that 82 per cent of respondents surveyed across urban India favoured job guarantees in comparison to just 16 per cent who chose cash transfers under the Universal Basic Income (UBI) scheme. Despite the second wave entering rural areas and lockdown in several states, the demand for work under MGNREGA is on the rise, according to the data released by Rural Development Ministry.

The budget allocation for the rural job protection scheme was increased in 2020 and enrolment under it saw a 50 per cent rise at least but still a lot more is needed as an urban version of the plan will soften the blow on citizens most affected by the coronavirus fallout, which has set Asia's third-largest economy on course for its deepest contraction in history, for which the Fiscal Responsibility and Budget Management Act must be relaxed and there should be an increased expenditure in infrastructure which will create jobs in the construction sector as well as increase private investment.

MMT argues that fear over government debt is needless. Sashi Sivramkrishna, an MMT researcher, said in one of his works that, "simple accounting tells us that public debt (liabilities) must be someone's asset- which it is- the private sector's financial asset". MMT suggests dismantling arbitrary fiscal deficit target numbers and an increase in direct spending on rural and urban employment would create a virtuous cycle of growth and employment resulting in taming the deficit. Hence as said by John Maynard Keynes, "Look after unemployment and the budget will look after itself".