SSRG International Journal of Economics and Management Studies
ISSN: 2393 – 9125 / https://doi.org/10.14445/23939125/IJEMS-V6I12P107

Volume 6 Issue 12, 59 - 69, Dec 2019
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Original Article

The Political-Economy of India…

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***Abstract* -** *Inflation reduces the value of capital. Although the Indian economy is growing fastest among the major world economies, its current growth rate is lower than its peak performance after the global financial crisis of 2008 when the economy received fiscal and monetary policy stimuli by the policy-makers, which kicked off the growth rate in the following years. However, the inflation–rate also soared to double-digits which the central banks tamed by tightening the money supply and increasing interest rate, and the government also curbed its expenditure in the wake. Nonetheless, the previous UPA government continued the stimulus longer that pushed inflation to intolerable heights when INDIA is still a developing economy with various types of constraints over investment and supply. The last decade of the country's growth path shows that the economy is responsive to an increase in money supply, either by monetary policy or fiscal policy, but in a supply-constrained scenario, the economy easily starts overheating or inflating.*

***Keywords* -** *Political, Economy, India.*

I. Introduction

Inflation is an important determinant of investment and growth. Foreign investors deter investment when they experience and/or expect inflation and depreciation. Then the question arises that "How, then, inflation be good for domestic investors or investment?" Inflation more than an increase in wages or income reduces real wages and demand and hurts growth. Some economists also argue that inflation reduces the value of debt even when the nominal interest rates go up, and you pay more in money terms. Inflation reduces the value of money, thereby reducing demand for other things and increasing demand for money wages that makes the economy uncompetitive. Higher prices also reduce domestic demand by increasing nominal interest rates and reducing real-interest-rate which also reduces savings which could further be translated into higher interest rates and low investment. Inflation is a signal. The rate of inflation discourages investment, demand and economic growth.

…Inflation reduces the value of capital, which means less investment….

II. Capital

Capital is another, apart from Labour and others, an important factor of production on which investment depends to a large extent which has a cost and price, and, a demand and a supply of money or Capital, Keynes demand for money equation are popular, and supply is controlled by the central banks, there are strings of measures of money-supply (M0, M1, M2,.) which varies with investment and demand, and, inflation and full-employment and growth.

Investment could be important for the economic growth rate. The central bank controls the supply of money and demand for money
by moving the real interest rate, i.e. by nominal interest –rate and inflation… Across the Globe, to a greater degree, now at this stage,
the neutral or natural rate of real interest rate is around 1 - 2 %. In INDIA, the RBI has said that it would target a neutral rate of real interest rate of 1.25 % in case of low and stable inflation. The RBI has set a band for inflation 4 +/- 2 and has committed an accommodative stance. The interest rate is on a downward trajectory, interest rate expectations are also biased lower, and we have a pickup in the investment cycle, although tepid. The investors track the GDP growth rate for investment decisions, and lower cost and price of Capital would increase investment and growth. This has been a long practice in China, and they always project a higher growth rate. The cost of borrowing might be positively correlated with the rate of economic growth, and a recent study shows that there is evidence of low but positive significance between economic growth and the real interest-rate, and. Income and demand and supply and profits, and lower-income and demand expectations would lower the warranted rate of economic growth and investment. The supply-side may be positive for employment, income, demand and economic growth through the real rates offered to the businesses and investment. The businesses can borrow either from banks, bonds or equities or through personal borrowings, and for all this, they play a real interest rate for the money [1]. All businesses have a degree of risk because of the uncertainty of work and income. The economy swings between boom and busts, the trade-

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cycle theory. The are several types of hedges the market has to proffer for investment, there are interest-rate derivatives, currency-derivatives, commodity-derivatives; this help to avert the risk to the series of incomes from the investment and the interest incomes, but it is difficult to demand less money for investment when you want higher interest rate from investment. The demand cuts the supply curve at a point where demand meets supply and decides a level of real prices or income and demand. A recent study shows that prices decide the level of demand and the economic growth rate [2] when lower prices are more expansionary because of the lower cost of borrowing. The price of Capital, i.e. the real interest rate, is one important determinant of investment and the economic growth rate. The supply and demand of/ money bear a real rate of interest which also depends on the rate of inflation and inflation reduces the value of money and real returns. Out of all the investment vehicles, bonds are largely inflation-protected because, for them, either yield increases or prices with the general price level. Recently, the RBI has liberalized foreign borrowing through Masala-bonds, i.e. bonds denominated in Rupees, plus the RBI has tried to develop INDIA's Corporate-bond-market. The RBI has signalled expansion in the balance sheets. So there is a lot of scope in borrowing from abroad. Moreover, if the investor wants to invest, s/he can hedge the interest-rate movements by derivatives. Loans in foreign currency could increase the foreign-exchange reserves, meanwhile. The competition from foreign countries to sell loans would also aggravate the competition in the domestic market and would push the real interest rate to the real marginal cost. The RBI has increased competition in the market to borrow through bonds. Historically low nominal-interest-rate levels in the developed countries presented the opportunities to borrow for a long-time now after 2008, and negative interest rate is a big part of the developed world signal lower-interest-rate projection and expectations that would also bolster borrowing in the emerging markets [3]. The real interest rate paid for foreign loans would be low enough because interest rates are near zero, and inflation in INDIA is around 4 %. Now, we have a minus 3-4 % of the real interest rate, which should promote investment. Nevertheless, it could be hedged through interest-rate derivatives and/or currency derivatives… However, in the last interest-rate cut cycle, the RBI was also told to control capital-inflows because of overheating.

III. Labour

Labour is the most important factor of production or production function, apart from capital and organization. Like any firm, lower cost of factors of production increases profit, other-things remaining constant. Cost of capital, often than labour, is the core of discussion circles, but the labour market also has a more direct link with the long-run movement of the price-level and economic growth, as the evidence from the developed countries show that real-wages have grown down in the past decades and interest-rate-trajectory has also shown a downward trend in the neutral rate or the natural-rate or equilibrium exchange rate in the same period and prices have also gone down [4][5]. Since the interest rates are often discussed; therefore here we would concentrate mainly on the labour cost of the production function. As the lower cost of interest-rate or borrowing, lowering labour cost of production has been a crucial way to incentivize or stimulate supply for the same lower cost of production and the same profits. Like lowering the real interest rate by inflation, increasing inflation would also lower real wages and cost of production; nonetheless, nominal wages may also increase since the economy would try to balance in terms of demand and supply and prices, and this process has a cumulative- effect on the same variables. When the money supply is increased, it also affects the three factors but in a magnified way, and the economy goes through credit or trade cycles. During booms, real wages and interest rates increase, and during busts, they go down; however, the part of the government is to regulate or ride the trade cycles through counter-cyclical monetary and fiscal policies by manipulating real wages interest-rate and exchange rate [6]. The price of labour or real wage is responsible for equilibrium in the labour market, we have heard of market-clearing prices, and higher real wages would increase labour supply. But, the economic models assume subsistence-wage-theory because of better negotiation-power of the Capitalist and influence on the three rates… Capitalists try to lower the above three rates, but higher skills increase income or real wages… INDIA's unemployment rate is close to its natural rate, and the economy doesn't need too much higher stimuli in terms of higher income, demand and supply, and economic growth, but it still needs to push since it has a young population and a higher labour-force participation rate. The rate of growth of the workforce decide the natural-rate-of-–economic-growth and lose money-supply increases it, and higher real wages would improve consumption-demand and economic growth by lowering the price-level through lower nominal and/or real-interest-rate and higher-supply… In INDIA, labour is cheap. Therefore it is profitable to invest in labour-intensive production when the borrowing cost is high. However, the investors might hedge them through interest-rate derivatives when the neutral-real-rate assumption is now close to 1.25%, lower than the previous target, and nominal rates are also likely to go down further… Lower borrowing costs would increase the ability to employ and increase wages… In the long

run, 5-years ahead, an increase in real wages is needed to boost demand-supply and economic growth. The unemployment benefits and social security net during slowdowns may help contain demand. They are important… Moreover, sometimes a little higher unemployment rate is significant for lower price-level to increase real wages and demand in case of lower population-growth rate and the economic growth rate.

IV. Food inflation is holding us back

The food inflation that is rampant in the Indian economy could be primarily ascribed to the low level of technology, investment and over-dependence on rains for irrigation have made the RBI delay rate cuts in the expectation of a good monsoon and lower prices of food. However, INDIA is also a big exporter of cereals (rice and wheat), in which inflation is close to 6.3% and had been higher in the previous years, could be brought down to a lower level if we try to reduce exports and increase domestic-supply to lower inflation. The men in authority argue that they cannot increase domestic supply by restricting exports because it would lower domestic prices of cereals and would hurt farmers. Nonetheless, everybody, the government and the RBI, still expect that a better monsoon would help bring down the inflation in cereals; therefore, if we increase domestic supply by curbing exports, it would have the same outcome, lower prices. INDIA could easily lower some of its inflation by curbing the export of cereals. Food inflation has kept the RBI in the delay mode in the expectation that time may itself improve the supply-side without lower-interest-rate. However, the government has committed interest-rate subvention, which might not work with credit-facilities-gap in the village areas where most of the farmers are forced to borrow at very high rates from traditional money-lenders. Agriculture has now become a high cost and risk sector of the economy because of high rural credit costs and holes in irrigation facilities [7]. Lack of irrigation facilities and agricultural loans has been the main culprits for farmers' suicide. The policy setters must try to eliminate these repercussions, which would also reduce inflation and interest rate and propel economic growth. The prosperity of agriculture, lower food inflation and lower interest rates are sine-qua-non for a healthy-high economic growth. Nevertheless, allowing 100% FDI in food retail and processing was a major supply-side reform of this year's budget, which might again help reduce food inflation and increase farmers' income by improving the supply chain and storage and by reducing the middle man chain in the agriculture. The government has pledged to increase farmers' income in five years, which would affect demand and growth positively. The government's vision of the rural and agricultural economy would take time to materialize to bring out their best, but implementation is the key, and the sooner it is, the better it is.

The average inflation target for the coming five years is 4%, with a band of +/- 2% given the high food inflation experienced almost every year. The prices of one or more basic food items catch fire each year. Food and fuel are important from the point of view of inflation and volatility and have a higher weightage in the inflation index. However, low fuel cost in the near past made the inflation target achievable even when food inflation remained high, and the government imported pulses on a large scale to cool down its domestic prices [8]. The two successive droughts in the past years have worsened the food inflation and lowered the rural demand and growth. At one place, income has come down, and at other, inflation has gone up, which have kept real incomes lower in the rural areas when the economy is still recovering from a downturn. Inflation too is responsible for lower demand and growth because it reduces demand for other G&S. Nonetheless, the hope of a good monsoon and lower food inflation comfort the economy in terms of lower expected inflation and interest rates on account of the credibility established by the RBI to check inflation and inflationary expectations in the past. The RBI sacrificed growth to contain inflation and has now an inflation target out of which it is expected to tighten and below which it would lower interest rates. Like rate cuts, rate hikes could also be delayed in expectation of lower prices adjustments. The central banks indirectly manipulate interest rates through the money supply, and the RBI has committed a liquidity-neutral stance which also means the natural rate at which there is neither inflation nor deflation. If there were surplus liquidity, there would be inflation, or when there is a deficit, there would be deflation. INDIA is yet to achieve that rate, but food inflation is a volatile category that requires more supply, and that is determined by a number of variables other than interest rates like weather, trade restrictions and farmer's welfare. Deflation should be considered different from disinflation. Opposite of the developed world in deflationary pressure, INDIA is going through disinflation. Deflation occurs when the price level goes below the base year. However, when there is scope for imports to cool down domestic inflation and lower interest rates, the government could bring out tenders and might provide interest-rate subvention, which would help bring the overall inflation and interest rate down…

V. The Irrigation-Gap

In INDIA, prices of food items are largely irresponsive to changes in the interest rate due to monsoon conditions which have had been a major source of worry and concern to the farmers. Although the

government has put interest-rate-subvention in place for agriculture, the unexpected weather- circumstances coupled with lack of irrigation facilities have turned the tide against the development and growth efforts through monetary and fiscal policies. Therefore, even if the interest rate is low, it barely corrects the monsoon vagaries and the irrigation gaps [9]. It looks meaningless to tackle the problem of weather and irrigation through higher interest rates.

The inflation we experienced during the last few years of the UPA government may be ascribed to misdirected expenditure to increase demand and growth with supply-side bottlenecks in food management. We have come too far with half of the agriculture devoid of irrigation and good weather, which we have to take with a pinch of salt. None of the governments after the Independence ever showed their full commitment to this big problem. We have been too much dependent on rains for irrigation and food. Nonetheless, the current government at the Center has taken stock of the situation of the agricultural economy, wages, incomes and demand, which rests too much on the rains.

We hope the present government will show its willpower to implement its plans for rural and agricultural welfare and demand and economic growth.

VI. Prices, interest rate and bonds

Liberalizing the bond market in INDIA would increase the money supply resulting in a lower interest rate. The RBI has also proposed to liberalize foreign borrowing through masala bonds. We now have competition from abroad to sell debt. Masala bonds are rupee-denominated bonds offered to overseas investors which do not need hedging [10]. However, borrowing in foreign currency must be hedged by currency derivatives [11]. Economists do not favour borrowing in foreign currency because of the lower reserves and also because it cannot be printed by the central bank. If you could borrow from a foreign country at lower-interest-rate, domestic demand for funds would go down, and domestic banks would lower-interest-rate to increase their demand. Domestic lenders would face competition from abroad. Moreover, an inflow of foreign funds would be also likely to lower the interest rate. More investment and more supply could also lower the price level and interest rate. It would help the transmission of rate cuts by the central bank.

Lower-price-level and lower bond yields mean higher bond prices and returns. A negative yield would even increase bond prices more. Bonds are already inflation-protected since when yields go down, bond prices increase. The real value of bonds is protected [12.] More supply of savings would lower bond yields and increase prices; therefore, bonds are safe. Lower prices increase the value of savings if other things remain constant. Low inflation and interest-rate mean savings would be discouraged, and spending would be encouraged. Including the dynamics show that in the future, inflation and interest-rate would rise because of higher spending. Lower prices or higher real-interest-rate could make people save more and spend more, while higher prices or lower real-interest-rate would increase the supply of savings and could decrease spending. According to Wicksell, a higher real interest rate means a higher return on capital [13]. We need to explain the relationship between economic variables in the dynamic sense because expectations are equally important for the outcome. The real world is dynamic.

Keynes said that money is not scarce when the central banks can print currency. Supply-side problems and inflation is the main cause of tight money supply because it reduces the value of capital [14]. If they are not present, then the central banks may continue to lose money to increase employment, demand and economic growth and, in some cases, with negative-real-interest-rate. Public spending, that boosts innovation and productivity, on education, skilling or re-skilling and, if necessary, on infrastructure is important for increasing real-wages, with low inflation, and demand and economic-growth when population-growth-rate and demand is going down in most of the developed-world - Japan, the US and Europe.

VII. Lower real-wages lead to lower demand and growth

All the countries are trying to increase their per capita income and living standard according to the increase in productivity while maintaining their competitiveness with innovations because labour is relatively scarcer, which might restrict the economy's capacity to absorb capital without increasing wages and the general price level, as found in the general quantity theory of money.

Productivity is measured by output per labour (Y/L) and output per capital (Y/K). If these increase over time, we can say that productivity has increased and vice-versa. Productivity can be measured. We need a productivity growth rate to decide the growth of returns to factors of production. We are here talking about productivity that increases supply capacity to sell more at lower prices. In the market, there is competition to sell at low prices. A direct factor that drives productivity is knowledge or innovation.

More money supply has reduced the cost of capital with low wages increasing supply despite low demand, which has lowered the general price level and interest rates pushing the economy at the zero lower bound or

liquidity-trap for a longer period. At the zero lower bound, cash hoarding increases, not necessarily in banks, because the value of money goes up in the face of lower prices. Moreover, everybody expects higher inflation in the future because it is our basic observation that prices increase with time, and the will to hold unlimited money also increase savings.

The zero lower bound also trims the possibility of increasing investment and employment by reducing the borrowing cost or nominal interest rate, but the central banks are trying to reduce the real interest rate and wages with inflation to incentivize the supply-side and profits which would also increase the relative international competitiveness to survive in the market-place.

A higher current-account-deficit (CAD) in most of the developed -world means you have to devalue, either by cutting on nominal wages, interest-rate and prices (internal-devaluation) or by cutting real wages, interest-rate and prices (external-devaluation) by increasing inflation [15][16]. In internal devaluation, the money supply is tightened to lower inflation, to cut down nominal wages and interest rates. In external, the money supply is loosened to increase inflation and cut down real wages and interest rates. But, we have evidence of downward-nominal-wage-and-price-rigidity after a point. In most of the developed world, there has been a cut on real wages despite increasing productivity. There has been a real-wages and productivity gap for a few decades.

Nonetheless, when real wages are going down, demand is likely to remain subdued, resulting in a lower growth rate. But, if we pay equal to the marginal product or productivity, there would be no inequality issue. Economists favour reward to factors of production according to their product which is the purpose of Economics (explaining income-distribution). It is among the stylized facts that the share of labour and capital should be equal in GDP, and real wages would rise in the long run. Labour-saving technological progress and higher productivity may be the reason for higher capitalists' profits, but real-wages-productivity-gap is observable in the charts.

VIII. Lost Jobs and Unemployment Benefits

The Bankruptcy-code passed back was among the most important forms of legislation of the parliament; besides the GST and the price-control during high inflation, the government has proposed to set prices of some categories during high prices due to demand and supply mismatch and lower interest rate and unemployment (more jobs) [17]. The uncertainty before the Bankruptcy-code on the hiring and firing of employees was a major roadblock in the way of starting investment and employing people when the Indian economy is growing at high speed even when the developed world is going through weak demand, which has undermined the Indian exports and achieves us double-digit growth-rate. Once a company is declared bankrupt, it becomes easy to lay off labour and dilute the assets to pay bank credit or credit… During slowdowns, unemployment or lay-off increases which lower demand growth and investment and lowers the price level, whereas due to boom employment or hiring and demand, growth, investment, and prices increase. The bankruptcy code deters firms to fire labour because of loss or low demand. The market that has a weak labour bargaining power employ more people temporarily than a labour market which gives importance to permanent jobs. The temporary labour by contract could be fired when there is a downturn. The bankruptcy code was positive for firms to decide for solvency; naturally, a bankrupt firm could not support workers because of a balance-sheet recession. Nonetheless, an economy with more permanent jobs is likely to recover fast during a slowdown because demand would go down less, while an economy with more temporary jobs would take more time to recover. Lower nominal wages given to the labour could be substituted for lay-offs; lower nominal wages instead of complete lay-off could help the economy to recover fast, however during heavy headwinds, it is not possible to continue employment. Lay-offs might be the last option used to tackle unemployment demand and growth. Notwithstanding, the social-security-net by the government is also a land-mark labour-reform, but INDIA still face a void in terms of a comprehensive unemployment-benefits plan because it is true that during the recession, firms employ temporarily and create low paying jobs or fewer jobs [18]. Unemployment benefits during downturns could replace the demand lost because of joblessness…

IX. Globalisation Reduces Inequality

Globalisation increases choice, which could be a step towards a more free society. The options to the society increase. It increases the choice of work and living; you can choose to live in the country of your choice and choose the work according to your specialisation. Globalization leads to specialisation. Even the Foreign-Trade-Theory is based on the specialization point; they say we need to specialize in the line in which we have a comparative advantage. It says to export that product which it could produce at low cost and prices; it says to specialize along those lines. Lower prices are the foremost argument in favour of Free-Trade and globalisation, which would increase real wages and the standard of living. However, economists are conscious that higher imports may reduce domestic employment

production and profits. Notwithstanding, globalisation, as has been said before, is good for real wages and equality. Capital is moving from the rich world to the poor countries, which have set the process of sharing prosperity through immigration, too. Countries tend to allow immigration of high-skilled workers in order to provide the domestic people with skills and higher-standard of living; nonetheless, skills can be acquired to improve wages. Globalisation increases choice and prosperity, but there should be full employment in the domestic economy. Protection is often sought for protecting the full-employment objective of the economic-policies with lower general-price-level [19].

International-trade increases employment, real wages, and demand in the global economy, which further means higher production and growth rate and more taxes to help eradicate poverty. The presence of more companies in the economy would increase revenue and public spending on necessities. The presence of domestic firms in foreign countries would further increase profits and taxes. It generates employment income and demand in the global economy.

Foreign investment, which increases employment to achieve full employment, must be given access to domestic markets. Trades that destroy domestic jobs are not feasible. More companies in the country would lower prices and increase wages, too.

Immigration might also help increase the labour-force-participation rate and increase the economic growth rate. It would reduce overheating in the domestic economy after full employment.

It is good for lower wages and price stability and could increase the growth rate and demand within the economy.

X. INDIA Must-Try the New-Model

The goal of economic policies is to achieve low inflation and low unemployment with the highest possible potential for economic growth. The first two are the primary objects, while the economic growth is the underlying objective. Probably, market stabilization might entail these. However, we do not need MSS [Market Stabilization (Securities) Scheme], because inflation and inflation expectations are committed lower in INDIA with a bias for more expansion in the money supply and the expected growth rate, which has a direct effect on investment, unemployment and (wages and) incomes and the demand and the economic-growth-real-GDP. Higher expected economic growth rate or the real-GDP (expectations) incentivizes investment. In the Harrod-Domar sense, it is warranted growth. We have two other growth rates. The actual-growth-rate-the current-growth-rate-and the natural-growth-rate or the potential-growth-rate - the rate of growth of the labour force [20].

The convergence of all the growth–rates is in the same direction in the long run. When the actual growth rate diverges from the warranted growth rate or the expected growth rate or the natural growth rate or the pace of increase in the labour force or the economy produces fewer jobs, or there is unemployment or when demand and inflation are low, we require to lose money-supply. Otherwise, we need tightening in case of high demand and inflation. A higher actual growth rate might also increase real GDP growth-rate expectations in the next period.

Shaping expectation is one important task of the economic policies… But, shaping expectations sometimes may take time… It works with a lag or when people actually feel the outcome or based on the current situation when they know which policy suits them better and create a positive response. For a very long period in history, inflation and inflation expectation were more common than deflation. However, countries like Japan, are reeling under deflation for the past two decades and have tried a lot to increase inflation and inflation expectation to cut real wages and for competitive exports.

Withstanding, lower real-wages-than productivity has crippled domestic demand and also the external demand (for imports), which has set the process of evaporating wages gains and demand. However, international trade is more expansionary, but at the cost of the domestic demand. But, why a country would increase exports at the loss of the domestic demand…? Domestically, lower prices and higher consumption would increase welfare.

Therefore, it is fairly possible to have disinflation or deflation and expectations based on the historical evidence as in Europe and Japan, where interest rates are negative to ward-off deflation.

Economists' fear that deflation would make people delay purchases in the expectation that lower prices are ahead, but everybody knows that supply is limited… People would rush to buy the inventories… Moreover, lower prices would help lower-interest-rate and may also likely increase internal devaluation and increase exports.

INDIA needs not emulate the old model for inflation, depreciation and exports… However, occasional depreciation of the Indian currency could increase exports, too.

INDIA might also help to increase exports by increasing demand for imports and higher real wages in the trading-partners economy… Higher real wages abroad could also increase demand for Indian exports, whereas higher real wages would also boost domestic demand…

Lower prices would increase real wages – at home and abroad too…

Lower prices and higher real wages and incomes expectation would increase demand and spending and the economic growth rate globally, including the domestic economy.

XI. INDIA could follow Germany for demand and exports

The recent deceleration in the exports has been a source of concern for the Indian economy when the external environment is not conducive amid a slowdown in many parts of the globe, now, including China with falling growth forecasts and a lower current account deficit on account of the falling crude-prices and healthy reserves buoyed by high FDI inflows has shifted the policy-makers attention away. However, INDIA still needs to look at the sector for double-digit growth, for which it would have to increase its competitiveness through appropriate monetary, fiscal and international trade policies. Competitiveness in international trade could be brought up by either internal devaluation or external devaluation. Economists generally advise external devaluation over internal devaluation because the exchange rate is more flexible than changes in the prices of commodities and services. Nonetheless, evidence shows that wages are stickier than commodity prices which might increase real wages and demand when inflation is low. But, the external devaluation reduces domestic demand by increasing inflation and cutting real wages (nominal interest rate minus inflation). The nominal exchange rate depends upon money-supply, inflation and inflation expectation. Foreign exchange is also an instrument for investment for which inflation and expectation of changes in it matter. Nonetheless, internal-devaluation is also not uncommon, and Germany is an alive and living example. It has used internal-devaluation, except external devaluation, to increase the competitiveness of its exports and has a considerable trade surplus. Germany recovered fast during the past recessions than other countries in Europe. Low inflation and inflation expectations have kept wage-demand low which has made German exports competitive, and although productivity has increased slowly, real wages have been increasing, which has also maintained the domestic demand. If INDIA is to fulfil its exports and double-digit growth ambitions, then internal devaluation looks more suitable because it would increase both domestic demand and foreign demand by increasing real wages and real exchange rate (nominal exchange rate minus inflation) by adopting and communicating a low price and inflation policy. Replacing inflation and inflation expectation with low inflation and low inflation expectations might be the better way to go around. Many of the developed countries has actually cut down on real-wages by external-devaluation and depreciation during the past few decades with inflation in order to achieve trade competitiveness which has strangulated and stagnated domestic demand in these countries, and they are trying higher inflation and inflation expectations through the Quantitative-Easing and lose monetary-policy which have also reduced real exchange rate and foreign demand. Germany's internal-devaluation might be a good idea and guide to increase demand than China's external-devaluation [21].

XII. Demonetisation (Tuesday, November 8, 2016)

Modi government (today) has banned the exchange of Rs 500 and 1000 notes from curbing the black money or the shadow economy and counterfeit currency menace the Indian economy is facing, which is expected to have a long-run effect on the demand and supply as well as the prices and unemployment within the economy. The step is likely to reduce the amount of money that has entered the economy through wrong channels like tax avoidance and fake currency by the neighbours to sponsor terrorism. This is the undesirable money that is coming into the economy for destabilizing it and not good for the country in terms of demand/supply and prices or inflation. The black money is often turned into other investments and is often hoarded under the mattresses. This is already known that the magnitude of black money within the economy is far greater than the black money that has been kept in the foreign economies to evade tax. The decision by the government would rule out the possibility to trade in other investment asset classes like gold, land and property, and their demand would go down… In another way, it would reduce the demand for everything that could be purchased with the black money, which means overall demand in the economy could go down with the decision to remove the old 500 and 1000 rupee notes from circulation. The measure could increase the real value of money in the economy because now money is less, which means demand and prices would go down. The relative quantity of money would go down compared to the goods, which would push down demand and prices. However, the government has reduced the number of notes in a big cash transaction. Nonetheless, the more use of debit or credit cards in the transactions would too help to account for the source of money and verify whether the

money is not unaccounted for and prior taxes have been paid… The decision to cut back on the black money should benefit everybody in the same way in terms of the value of money, which could go up with lower demand and prices, except black money would go out of the market… It would increase real wages and income and wealth… Lower prices increase demand and spending – consumption and investment – and the economic-growth-rate…

XIII. Demonetisation and the Monetary-Policy

A complete cashless economy where transactions from a bank account are mandatory could disincentivise cash transactions by attracting investigation and lawsuits on big transactions with unaccounted money on which taxes have not been paid. To dramatically reduce the circulation of black money, the government might have made the use of debit or credit cards with a pin number in 30 days with the help of some software in smartphones to verify fingerprints and the bank account number. We already have Adhar-card and Jan-Dhan bank accounts. The bump would have been narrowed. For this, too, we would need bank deposits for future transactions. Money had come to the banks in the form of deposits. Modi has still left room for future black money by not abolishing cash transactions altogether. Still, notes could be hoarded.

A thought over this move on its effect on the economy is crucial to convey the idea behind the government decision to unearth black money to the public. The whole concept is to ban the use of unaccounted money and fake or counterfeit money in everyday transactions, which may affect the demand within the economy in the short run. To remove fake currency from circulation, the government measure is also to curb terrorist activities in the short-run is the most important argument in favour of a ban of high denomination notes for which little-pain in the public life comes worthwhile, besides black-money. The security of human life is more important.

However, lower consumer spending with only white money due to disruption in the supply of notes is hurt. The consumption is being delayed till the crunch is over, and we are back to normal life in terms of money supply and demand. Nonetheless, the rate of price-rise or expectation about it would decide the same in future, too, including the prices. The ban on high denomination notes may negatively affect demand and invalid demand, both in the short-run but in the long run. It is likely to curb invalid demand or black-money demand to a greater degree.

The total demand less the demand dependent on the black money might help reduce prices to a significant level which would increase real incomes in the medium-term. All those things that could be purchased with the black money would see price reductions and an increase in demand as life gathers momentum with the right money supply. The reserve bank has committed a liquidity-neutral-stance to lower inflation and inflation expectation and employment and production and the economic-growth-rate.

The monetary policy should try to match demand and supply of notes and quantity of money with the pre-ban levels. More deposits in banks could lower the rate of interest and increase investment. Lower prices may help increase savings and investment in the long run. The RBI must try to keep demand intact by lowering the key interest rates. We may expect a rate cut in the upcoming monetary-policy reviews.

Lower prices and lower-interest-rate in the near term would prove to be expansionary and beneficial for demand and growth.

The retail inflation in October 2016 has come lower to 4.2 %, which also fosters rate cut expectations when we have set an inflation target of 4% with a band of +/- 2% in the medium-term.

The real-interest-rate-cut expectation is also lower when inflation has scored lower, and the RBI has set a neutral rate target of 1.25%.

XIV. Expansionary Policies after Demonetization

Amid the arguments, the debate on demonetization has come close to the point that it has hit the money supply in the pockets of the public since a large part of it is banned with the move to demonetize (old). Rs 500 and Rs 1000 notes… Almost 80% of the money supply… Having noticed the changes in the key economic variables like demand, supply, prices and unemployment in the market over two weeks, we may find that there are many slips between the cup and the lips… The move has struck the demand in the economy by way of demonetization of the high-value notes to curb black and counterfeit monies, and in the same way, it has also restricted the supply-side by reducing money to finance business, even exports have been down. Almost everybody feels that the bold measure to curb black money and fake currency, though even with good intentions, has slowed down trade and employment in the economy… That, the decision is likely to be a pain in the short-run, but the economy would gain by reducing unjust demand and prices in the economy. In the long run, it would increase real wages and wealth… However, matching money supply to the

pre-crisis period is of utter importance… Previously, the RBI had an accommodative stance to liquidity… The RBI is responsible for doing the job; nonetheless, by increasing investment and employment and productivity or production, the government is equally responsible for keeping demand and growth high to tide over the wave of note-ban. The step could hurt the economic growth rate of the economy with a slowdown in the demand and supply and inflation and possibly unemployment, but lower price and interest-rate expectations might help increase investment, growth and employment in the future if income does not decrease. Lower prices and interest rates could increase spending in the economy in the long run… Keeping real-wages expectations high, the policy-makers might target higher real-GDP. Lower prices would increase real wages, real interest rate, and real-exchange rate and expectations, which are likely to increase demand and supply in the external sector, too… Both the RBI and the government are responsible for maintaining employment and wages and incomes and demand within the economy… They might work to keep demand and supply high by manipulating the money supply and fiscal expenditure to increase productivity through innovation and the economic growth rate… Notwithstanding, the will to curb cash transactions would decide the generation of black money in the future…

XV. Demonetization Would Increase Value of Money, Demand and Growth

The commentators on the demonetization are often heard advocating the positive long-run effects of it and that it might also cause disruption in the everyday exchanges with cash for some time since a large part it has been replaced by new currency and digital transactions, which seems to be right. The long-run effects would play out through the effect of money supply on inflation and interest rate, and the value of money. However, disinflation and lower-interest-rate observed after the demonetization due to lower cash, although unemployment has increased temporarily with the shortage of cash to finance economic activity, are likely to increase demand and growth rate in the future. Inflation in INDIA has come down in the data following the demonetization. Moreover, the expectations about jobs and incomes are not so grim because investors have only delayed investment, and the improvement in the supply of cash day by day would soon help to revive investment and employment. When income is more or less fixed, and inflation and inflation expectations are biased lower, would increase spending as soon as the economy adjusts to the money supply and demand. We generally assume higher inflation while increasing the money supply, but when it is reduced, we may also expect inflation to go down too because some of the demand and spending would go down. The black economy, which could be as big as a third of the white economy, might be an important source of demand in the economy, especially for a home. Prior, real estate was a cash and black-money oriented market that is now going to see a price correction because of demonetization, which is likely to increase the demand of the common people. It would make homes affordable for the poor section of the country. However, lower demand and prices would also lower the EMI and increase demand. When demand for construction would go up, employment would go up too. The real-estate sector is an employment intensive sector that mostly uses unskilled labour; more employment would increase demand and economic growth. Demonetization would help the government in its mission of house for all by 2022. Lower prices signal more spending if employment and income do not go down. It is more expansionary because real wages, real interest rate or real return on capital and real exchange rate increase domestic and external demand; lower prices could make the economy competitive. In INDIA's case, spending is only being delayed, which is likely to come back except the black-money demand, and people would find the market cheap after the pain period is over. Demonetization could lower money supply and increase the value of money because it would make money scarce relative to goods and services by way of lowering inflation and inflation expectation by reducing black-money dependent illegal demand.

XVI. INDIA Is Not Demand-Deficient, Spending Would Recover Fast

As the demonetization story is slowly unfolding in terms of the effects on the demand, supply, and prices and growth, expectations… about the future that how long we have been in the trail of facts would signal the agents to do the best in their budgets, investors included, during this short period of crisis of cash matter. If people felt that demonetization had benefitted them apart from the hardships they have faced, they would support it since it is a big social reform that is worth a short-run-pain since black money is a form of social injustice and add up to illegitimate demand in the economy. The common man is the agent to bring this big social transformation, from corruption to a clean system, since his welfare is dependent on good public services and state support in the form of direct benefit transfer and social-security net. Higher taxes are spent on the important things in life which are difficult to provide by a small vendor, and the money from demonetization would be spent on the welfare of the poor; the Pradhan-Mantri-Garib-Kalyan-Yojna (PMGKY) has been started to show the government's commitment to improving the condition of the poor of

INDIA. Good infrastructure and employment skills are sine-qua-non to a good standard of living and would help reduce poverty. Employment is the best insurance against poverty and exploitation, and the curb on black money would improve the distribution of income and reduce inequality. Black money in cash is saved after evading taxes that has a direct bearing on the spending on public purposes to increase the quality of life and social progress. Tax evasion is a crime against society, it holds-back development and growth, and higher spending by the government may increase demand and supply. Apart from this, a sweeping change could be expected when the banks are flushed with deposits and would be able to finance the loan demand at lower rates when we say that INDIA is not demanding deficient and the RBI has kept levers tight due to inflation and inflation expectations which would lower growth-expectation. However, it is expected to cut rates when it has maintained an accommodative stance in case of lower inflation. Demonetization has improved on expectations about loose fiscal policy and monetary policy in the next few quarters. The economy would definitely gain beyond demonetization because of better expectations for the key economic variables like low inflation, lower-interest-rate and higher spending, consumption and investment, and lower unemployment, too… The economy, meanwhile, is getting its maths right… Higher savings due to a limit on cash withdrawal would also be spent… Demonetization has increased expectations about the growth rate in the following quarters. The economic-growth rate could touch 9% in the next few quarters on the back of a rebound in demand till the cash-cripple is over because spending would recover at a faster rate …

XVII. CONCLUSION

INDIA has committed to a disinflationary path, also through demonetization, which is likely to increase real wages and expectations, but it took time to adjust to the right money supply when 86% of the notes are being replaced. The RBI is set to maintain the liquidity with Rs 2000 notes… The sooner the policymakers help mitigate the cash crisis, either by cashless transactions or other means, the sooner we would achieve stability in the market. Demonetization could help lower inflation and inflation expectations which would increase spending provided the cash-gap recovers soon.

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