

DOCTORAL PROGRAMME

ESSAYS ON LABOUR MARKETS, BUSINESS CYCLES AND
MONETARY POLICY IN INDIA

By
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**By
Abhishek Naresh**

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Abstract

There has been a growing interest to understand the business cycles in Emerging Market Economies (EMEs). However, the focus of the existing studies has been limited to understanding the dynamics of business cycles and documenting the effect of shocks to the EMEs. This dissertation builds further on the existing literature and explores the inter-linkages of the dual labour market, business cycles, monetary policy and inequality, with a focus on India.

In the first chapter, we begin by empirically documenting the asymmetric business cycles in both regular and contract labour markets in India. We then investigate the role of nominal wage rigidities and labour adjustment cost in accounting for the employment and output dynamics. Using data from the Annual Survey of Industries, we find that the output growth is negatively skewed. More importantly, we observe that the growth in regular employment is negatively skewed while that of contract employment is positively skewed. On the other hand, the nominal wage growth of regular workers exhibits positive skewness while that of contract workers exhibit negative skewness. Using a standard business cycle model augmented with asymmetric wage adjustment costs for regular and contract labour coupled with labour adjustment cost for regular labour does a good job of explaining the asymmetries in output and employment cycles. We also find that the presence of contract labour reduces the asymmetry in output growth by around 85%.

In the second chapter, we extend the framework of Chapter 1 to include both regular and contract households, separately. The regular workers have access to financial markets and accumulate capital, whereas contract workers do not have any access to financial markets and consume only from their labour income. In such a set-up, we then examine the role of wage adjustment costs and the determinacy property of interest rate rule. Our results show that determinacy is crucially dependent on the wage stickiness and share of the contract labour. We then extend the same model to study the optimal inflation in a dual labour market, with both the types of labour having opposite wage asymmetries. We estimate positive inflation required to "grease the wheels" of the economy; however, it is much lower compared to a scenario where wages are only downwardly asymmetric. Finally, we evaluate two different monetary policies from inequality and welfare perspective. By

defining a consumption-based Gini-Index of inequality and developing a utility-based theoretical framework for welfare evaluation, we conclude that wage inflation augmented Taylor rule improves welfare and lowers inequality compared to price inflation targeting Taylor rule.

The last chapter analyses an alternate policy of "money-financed stimulus" to finance government spending. We compare the efficacy of this policy with a conventional debt-financed stimulus. This study is important in light of unprecedented economic downturns. We analyse the fiscal multiplier arising by pursuing both the stimulus policies. The highlight of our study is that we use a consumption-based index to analyse inequality. Our model takes into account two separate households, i.e. Ricardian and Non-Ricardian households. Non-Ricardian agents or informal labour are an important feature of emerging market economies. In such a set-up we find support that a money financed stimulus has higher fiscal multiplier than a debt-financed stimulus. In other words, a money-financed stimulus leads to a sharp increase in output. However, money-financed stimulus causes a high inequality resulting due to consumption disparity among the households. On the other hand, debt-financed stimulus reduces inequality. The inequality also varies with the wage stickiness of the Non-Ricardian agents. We find evidence that a money-financed stimulus is a double-edged sword for the policymakers.

“Imagine a red lotus that had begun life underwater but grew and rose above the surface until it stood free. So, I too have transcended the world and attained the supreme enlightenment. Remember me as the one who woke up.”

This work is dedicated to the Enlightened one.