

Chapter-5

Conclusions

The study brings out the fact that the past studies have found mixed evidence about the shape of the Phillips curve from being horizontal to vertical. The researcher has also observed that there are very few studies about the developing countries including India. This may be attributed to the lack of availability of well defined, reliable and long run time series of data on unemployment. Similarly, evidence regarding the direction of causality between inflation and unemployment is also not conclusive.

To avoid meaningless or spurious regression all the variables used in the estimation of Expectation Augmented Phillips curve were tested for stationarity using Augmented Dickey-Fuller (ADF) test and Phillips-Parron unit root test. The variables test in levels as well as first difference. The hypothesis of the presence of unit root was rejected in all the cases by ADF test as well as PP- test. Therefore, the variables representing inflation, lagged inflation, output gap ratio and gap of output growth rates were found to be stationary.

The estimates of the model show that about 59 percent of the variation in inflation is explained by the model and the D-W statistic shows the absence of auto correlation.

All the coefficient are significant at 5 percent level except one which is significant at 10 percent level of significance. The present finding does not support the hypothesis of vertical Phillips curve. Rather it suggests that there is a short run Phillips curve in India. It is evident from the fact that the coefficient of lagged inflation or expected inflation is significantly less than one and different from zero.

Another important result is the estimated value of β_2 , the coefficient of output gap ratio. This represents the sensitivity of price inflation to the labour market disequilibrium. It is positive and significant. Since it represents the degree of responsiveness of the wage or price to the labour market disequilibrium, it determines the slope of the simple Phillips curve. Thus, the wages and prices are not sticky and there is a short run Phillips curve. There is a trade-off between prices and unemployment.

Another important result of the study is a negative and significant estimate of β_3 , the coefficient of gap of output growth rates. It represents the combined effect of h and q of equations 5 and 6 respectively. Since, q depends on marginal productivity of labour and can be assumed to be positive, h must be negative for the Indian economy. This shows that any policy aimed at rapid economy growth or recovery will not result in the rise of inflation. Rather it should reduce the involuntary unemployment. While, on the other hand, a slow recovery or lower growth rate may aggravate inflationary tendency in the economy. In sum, it can be said that India can reduce involuntary unemployment through faster and inclusive economic growth without facing the problem of inflation. But for that it must grow rapidly. Regarding the causation, the results show that the output gap ratio Granger causes the inflation but inflation does not Granger cause output gap ratio. Thus, there is only a unidirectional causation. But the gap of output growth rates Granger cause inflation and vice versa, i.e. inflation Granger causes gap of output growth rates. Thus, there is bidirectional causation between inflation and gap of output growth rates.