What is to be Done about Unemployment?*

Prabhat Patnaik

A Distinction is drawn in economics between demand-constrained systems and resource-constrained systems (which for simplicity and symmetry we shall call supply-constrained systems). In the former, an increase in output can occur if there is a rise in aggregate demand without causing any scarcity-induced inflation; in the latter, output is constrained either by capacity being fully used up, or by the scarcity of some critical input or of foodgrains or of the labour force, so that a rise in aggregate demand, instead of raising output, simply causes scarcity-induced inflation. Capitalism normally, that is, except in war times, is a demand-constrained system, while socialism that existed in the Soviet Union and in Eastern Europe was supply-constrained. In a demand-constrained system, employment too will rise if there is an increase in aggregate demand.

This distinction is important to keep in mind at present in India when unemployment has become a serious social issue, when its acuteness has been a major factor behind the BJP's humbling in the recent elections, and when its alleviation has become a matter of absolute priority.

Since there has been substantial deliberate curtailment of employment in the service sector including government services, where shortage of fixed capital stock has played no role, we cannot hold any capacity constraint responsible for the current level of unemployment. Likewise the current level of unemployment is not due to the shortage of any critical input. Foodgrains too have not been in short supply, as is evident from the fact that even the Modi government, which debunks transfers to the poor as "freebies", has been using up existing stocks to acquire some electoral goodwill by providing 5 kgs of foodgrains per person per month to a large number of beneficiaries; true, at this moment India is about to buy wheat in the international market to replenish depleted stocks, but this is due to mismanagement, not any basic scarcity of the grain in the country. The acute unemployment we have in India at present therefore is reflective of a demand-constrained system; its alleviation requires as an immediate measure a rise in aggregate demand, led by government spending.

There are large numbers of government jobs remaining unfilled; the education sector is understaffed to an amazing extent which is taking a heavy toll on the quality of teaching; even the armed forces have not seen their usual scale of recruitment because of which all kinds of schemes, like the "Agniveer" scheme, have been introduced. The government, in short, instead of taking a lead in providing employment, has ironically been cutting down on employment; the reason lies apparently in the fact that it feels fiscally constrained. Let us examine this a little more closely.

The basic distinction we mentioned above is between demand and supply-constrained systems. Other than supply constraints, which we just saw do not exist, there is no such thing as an objective fiscal constraint on a sovereign state. Any such fiscal constraint is imposed upon the State by international capital and its local counterpart, the domestic corporate-financial oligarchy; it is reflective of a loss of autonomy on the part of the State, not of any objective limits on the State.

The fact that in a demand-constrained system there are no objective limits on the capacity of the State to spend was demonstrated in the economic literature more than ninety years ago when the Kaleckian-Keynesian theoretical revolution had got going; and yet the false theory that had been debunked over nine decades ago is still resurrected today to pass off what are in effect constraints imposed by big business on the State as objective limits on the State. The pre-eminent requirement for alleviating unemployment is that the State must shake off its thraldom to the caprices of international and domestic big capital; it must re-acquire, and act on, its resolve to serve the people.

In a demand-constrained system larger government spending even if it is financed by a fiscal deficit still overcomes unemployment; its main harmful effect arises not because of any "crowding out" of private investment or other such bogus claims made against it, but because it gratuitously increases wealth inequality. If the government spends, say, Rs100, and finances it by a fiscal deficit, that is, by borrowing, then, in effect, it puts the Rs100 in the hands of the capitalists through its spending (since the working people more or less spend what they earn), and then borrows it from them.

This is easily seen if we break up the economy into three mutually exclusive and all-exhaustive parts: the government, the working people, and the capitalists (let us for simplicity abstract from all external transactions by assuming a closed economy). The deficits of the three parts must necessarily, as a mathematical identity, add up to zero in any period. Since the working people generally consume whatever they earn, their deficit (or surplus) is zero, if the government runs a deficit then it must automatically create an equivalent amount of surplus with the capitalists without their doing anything consciously about it. If the government spends by borrowing the Rs100 from banks to start with, then by the end of the period it can borrow the Rs100 of surplus from the capitalists that would have gratuitously accrued to them, and pay back the banks.

This surplus accrues to capitalists because of the larger demand for their goods generated by government spending. It is a gratuitous addition to their savings and wealth, and hence accentuates wealth inequality. To prevent such accentuation of wealth inequality, the government should tax away these Rs100 from them, and finance its spending by an equivalent tax on the capitalists, which does not even reduce their wealth compared to the initial situation. It follows that larger State spending financed by taxing the capitalists can increase employment without even impinging on the capitalists whose initial wealth remains unchanged. The State must have the courage to expand its expenditure and be prepared to face whatever road-blocks the domestic and foreign capitalists place against its actions (in the form for instance of capital flight) if it wishes to increase employment.

Expanding employment therefore requires, first, a filling up of all vacancies that exist within the government including of teachers at the school and university level, and of healthcare and nursing staff. Second, it requires an increase in the number of posts in these sectors; education in the country for instance has reached abysmal levels and it needs revival through an appropriate expansion of qualified staff. Third, it requires expanding the scope of the Mahatma Gandhi National Rural Employment Guarantee Scheme by removing its existing limits and making it universal and demand-driven; it should also be extended to urban areas and wages must be fixed at appropriate levels, well above the pittance currently being paid.

This itself will generate demand for a whole range of goods in the economy which will be met partly through a greater utilisation of existing capacity and hence through greater employment, and partly through the setting up of new capacity, including above all in the small-scale sector (for which appropriate arrangement of loans must be made). The provision of employment by the government in other words will create additional employment in the private sector through what is known as the "multiplier".

As discussed above, this entire increase in State spending will have to be financed through larger taxes on the capitalists and the rich in general. Such taxes can be on their flow incomes or on their stocks of wealth; of the two however a tax on their wealth, which includes real estate and cash balances that earn no significant direct income, is preferable, for it then cannot even be said to have any adverse effects on productive investment. Of course, any wealth taxation must be accompanied by inheritance taxation to prevent evasion of the former. What is shocking is that India has virtually no wealth or inheritance taxation, even when wealth inequality in the country has skyrocketed during the neoliberal era. This reprehensible fact however also implies the existence of immense scope for imposing wealth and inheritance taxation.

An increase in government expenditure financed by larger wealth and inheritance taxation provides the easiest and most direct route to the generation of larger employment in the economy. It will kill several birds with one stone: provide larger employment, keep wealth inequality in check which is essential for democracy, and improve the state of education and healthcare in the country from the abysmal levels to which they have sunk.

*** This article was originally published in the Peoples Democracy on June 9, 2024.**