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Financial anxiety and inflation: a burden for informal workers

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Abstract. *Individuals may experience significant financial anxiety as a result of inflation, which reduces the purchasing power of money and causes it to be challenging to afford basic necessities. Workers in the informal sector are excluded from formal protection and are vulnerable to a variety of risks related to income, health, and various other socioeconomic indicators that may affect their standard of living and economic well-being. With rising inflation, the economy's purchasing power is steadily eroding. In such salient times, the working population of the economy is supposed to be worried about their real incomes, especially the informal sector who do not usually have stable income and job security. Financial Anxiety is a psychological phenomenon wherein individuals fail to manage their personal finances without getting excessively worried. This paper aims to understand the financial anxiety among people with reference to the current inflationary pressures in India using primary data collected in the form of survey and personal interviews. It will also be associating financial anxiety with financial literacy to check if people who are financially literate are more anxious or not.*

Keywords: financial anxiety, inflation, informal workers, financial literacy, financial stress.

JEL Classification: E31.

Introduction

Economics and mental health are intertwined. Mental health has been a very ignored area for a long time. It is relatively a contemporary issue in the research field of economics. According to studies, one in seven individuals in India were affected by serious mental disorders in 2017. Since 1990, the proportion of disease burden of mental disorders in total disease burden has almost doubled. There is interdependency between mental health and economics. We all have experienced stress due to economic conditions around us. Similarly, mental health also affects the economy on the micro and macro level.

Financial anxiety has been defined as a psychosocial syndrome whereby individuals have an uneasy and unhealthy attitude toward engaging with, and administering their personal finances in an effective way (Burchell, 2003). Common symptoms are overspending, hoarding, fear of spending, uncontrollable finances, depression. Inflation has intensified a high degree of sociopolitical demoralization and anxiety. Inflation has been skyrocketing in India. With the rising inflation, the purchasing power of the economy is constantly declining. In such salient times, the working population of the economy is supposed to be worried about their real incomes, especially the informal sector who do not usually have stable income and job security. During the economic downturn, the link between recession and health has featured in many countries' media, political, and medical debate. A study by The World Bank (2019) found that informal workers are particularly vulnerable to inflation due to their lack of access to financial services and their reliance on multiple income sources. The study suggests that policymakers can address this vulnerability by promoting financial inclusion and improving access to credit and other financial services for informal workers. Additionally, policies that increase the stability of the economy and reduce inflation rates can also help to mitigate financial anxiety among informal workers.

Inflation can be a significant source of financial anxiety for individuals, as it erodes the purchasing power of money and makes it more difficult to afford basic necessities. A study published in the Journal of Economic Psychology found that "inflation anxiety" was a significant predictor of individuals' overall financial anxiety (Hira & Mugenda, 1998). Inflation can also have negative effects on mental health. One reason inflation causes financial anxiety is that it can make it more difficult to plan for the future. As prices rise, it becomes harder to predict how much money will be needed to cover expenses in the coming months or years. Financial literacy could be defined as measuring how well an individual can understand and use personal finance-related information (SJ Houston, 2010).

Theoretical background

Inflation in India skyrocketed like never before. All of this, right after the pandemic. When updating their beliefs, individuals place a disproportionate weight on the most recent events (Malmendier and Nagel, 2011), especially when these events are particularly salient (Bordalo et al., 2013; Tversky and Kahneman, 1973). As a consequence, belief formation may differ substantially in the unprecedented environment of the coronavirus pandemic as compared to more conventional economic shocks. Rational expectations theory (Mankiw and Reis, 2002) assumes that individuals make rational decisions based on all available information to maximize their utility. In the context of financial anxiety during inflation, individuals with high levels of financial literacy are expected to have a better understanding of inflation and its impact on their finances. This understanding enables them to make rational decisions and avoid financial anxiety. A study by Thaler and Johnson (1990) suggests that people's decisions are influenced by their emotions and subjective perceptions of gains and losses, rather than rational calculations. In the context of financial anxiety during inflation, individuals may experience anxiety even if they have a good understanding of inflation if they perceive it as a loss or a threat to their financial well-being.

The perspective of behavioural economics combines insights from psychology and economics to understand how people make decisions. In the context of financial anxiety during inflation, behavioural economics suggests that people may have biases that affect their decision-making, such as the tendency to overestimate the impact of inflation on their finances. Keynesian economics suggests that the government can use monetary and fiscal policies to manage inflation and stabilize the economy, which can help reduce financial anxiety among individuals. In the context of financial anxiety during inflation, Austrian economics suggests that individuals can make rational decisions to protect their finances, such as investing in assets that provide a hedge against inflation, like gold or real estate.

Discussion

Inflation can be a significant source of financial anxiety for individuals, as it erodes the purchasing power of money and makes it more difficult to afford basic necessities. The relationship between Financial Anxiety and Financial Literacy is that more financially literate people are less financially anxious. Being financially literate helps them in planning and managing their finances more efficiently that makes them less financially stressed in high inflationary times like the present. Many workers have accepted that having more information about the inflation rates has helped them to prepare better for coming times. The relationship between income and financial anxiety is quite obvious and evident. Financial literacy can play an important role in reducing financial anxiety, as it can help individuals make informed decisions about their finances and feel more confident in their ability to manage money. A study published in the Journal of Consumer Affairs found that "financial literacy was negatively associated with financial anxiety" (Norvilitis, Merwin, Osberg, Roehling, & Young, 2006).

When people earn more income, they are less financially anxious. This comes from the reason that with more income, they have a sense of safety to keep up with the rising prices around, during the times of high inflation. However, the relationship is not very strong. Size of income is not the primary factor for financial anxiety. The expenditure point of view also plays an equally important role. The weaker correlation also substantiates the response of many who have accepted that large sum of money makes them financially anxious.

The direct relationship between gender and financial anxiety shows that women are usually more financially anxious than men. The correlation between gender and financial literacy shows similar result that men are more financially literate than women. Now, intermediating financial literacy as a variable, we can simply say that since men are more financially literate, they are less financially anxious. This perspective has been narrated by some male as well as female participants. It basically comes down not to gender, but the role of decision-making when it comes to the crossroad of financial anxiety and financial literacy within different genders. Education, as a sociodemographic variable is very important in determining how financially anxious a person is. The correlation between the two variables shows that people who have received higher education are usually less financially anxious. Also, a person with higher education is likely to be more financially literate.

Looking into the variables related to finances of the participants, it has been found that people with savings are less anxious. Having savings can significantly reduce financial anxiety among workers due to several reasons. Firstly, it provides a much-needed emergency fund, offering a safety net for unexpected expenses, like medical emergencies or job loss. This financial cushion instills a sense of security and peace of mind, knowing they can weather unforeseen challenges without undue stress. Secondly, savings help workers avoid excessive debt, which can be a major source of anxiety. With funds readily available, they are less likely to rely on credit cards or loans, thereby minimizing debt-related worries and ensuring greater financial stability. Additionally, having savings empowers individuals to make more flexible career and life choices, pursue long-term goals like homeownership or retirement, and experience a sense of control over their financial well-being. Overall, encouraging workers to save and manage their finances wisely can lead to a financially secure and less anxious workforce. While savings are generally considered to be a helpful tool for reducing financial anxiety, there are some situations where savings may actually increase financial anxiety. One interesting example is, if an individual is saving for a specific financial goal but is not making progress towards that goal. Despite saving for down payment on her home, the individual is struggling to save enough money. In this case, the pressure to meet the goal can actually increase financial anxiety.

Most of our respondents have pressed on this topic while pointing out the amount of debt they have. It has come to the surface that the savings they have are not enough to pay off their debts on time, adding on the pressures of uncertainty created by rising inflation. While comparing the relationship between financial literacy and savings, a clear result shows that people who have savings are more financially literate. Most of our respondents have savings with formal institutions, that makes them more literate about the returns and interest rates they will receive. Results show that people who have debts to pay are more anxious than those who don’t. Even after bringing in financial literacy, we can say that in all the groups across financial literacy, people with debt are more anxious than those who don’t. The primary reason for such a prominent scenario is that, most of these informal workers have debts from informal sources. Majority of the workers mentioned that they have debts from their relatives and landowners. The contractual workers have debt to their contractors from the pandemic period.

People who have multiple sources of income are traditionally considered to stress lesser on their financials. However, we found that people having multiple sources of income and less financial literacy are more financially anxious. A study by the National Bureau of Economic Research (NBER) (2019) found that workers with multiple jobs are more likely to experience financial instability, which can lead to financial anxiety. Workers with multiple sources of income usually have to work longer hours or take on additional jobs to offset the impact of inflation. This can lead to burnout and stress, which can exacerbate financial anxiety. Informal workers with multiple sources of income have irregular or unpredictable income streams, which makes it difficult to plan and budget for future expenses. Inflation exacerbates this unpredictability, making it harder for workers to predict their future earnings and expenses.

Conclusion

Inflation can be a significant source of financial anxiety for individuals, as it erodes the purchasing power of money and makes it more difficult to afford basic necessities. Inflation has intensified a high degree of sociopolitical demoralization and anxiety. In such salient times, the working population of the economy is supposed to be worried about their real incomes, especially the informal sector who do not usually have stable income and job security. The workers in the informal sectors are left out from formal protection. Migrant workers, who often face language barriers, social isolation, and limited access to financial services, are particularly vulnerable to financial anxiety. Financial literacy is one of the most important factors of financial anxiety. Any group with more financial literacy has empirically proven to be less anxious by this study. This study states the importance of mental health to be taken into account in economic modelling and the role of financial literacy in causing or reducing financial anxiety. It may help in formulation of policy measures. Policies regarding financial inclusion will promote financial literacy, which will help in reducing financial anxiety.

Other factors like savings, debt, education, age, income sources, etc. are also significant factors of both financial anxiety and literacy. Informal sources of savings and debt is a prominent issue for informal migrant workers. By studying financial anxiety among informal workers, researchers can identify the unique challenges and develop tailored solutions to meet the financial needs of this population.

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