

Inflation – causes, effects and measures

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CAUSES OF INFLATION

- Demand-side Inflation(demand-pull inflation)
- Supply-side Inflation(cost-push inflation)

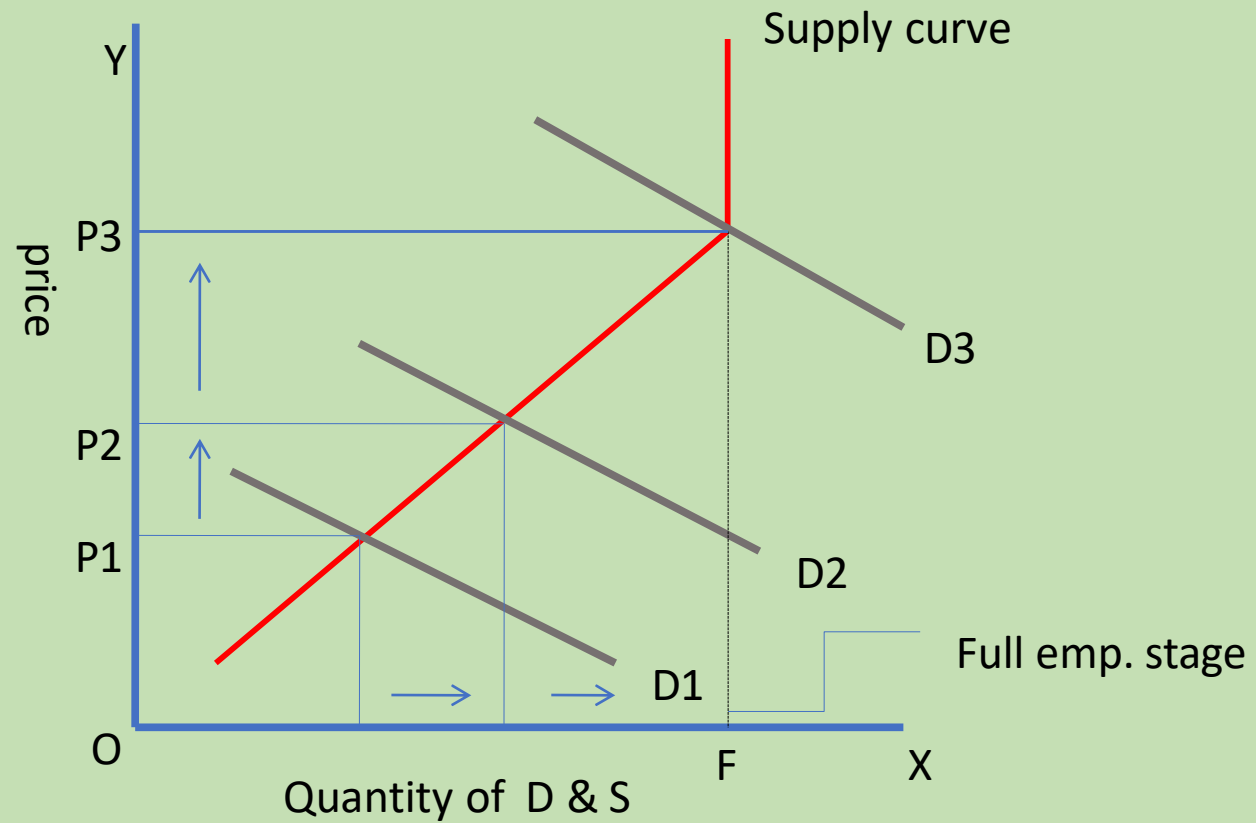
DEMAND–SIDE INFLATION

- One side of school of thought says that inflation is due to excess demand is called as **Demand-pull Inflation** or **Excess Demand Inflation**.
- It means demand for goods and services is pulled above the capacity of the economy to produce goods and services in a given time period.

FACTORS CONTRIBUTING TO DEMAND SIDE INFLATION

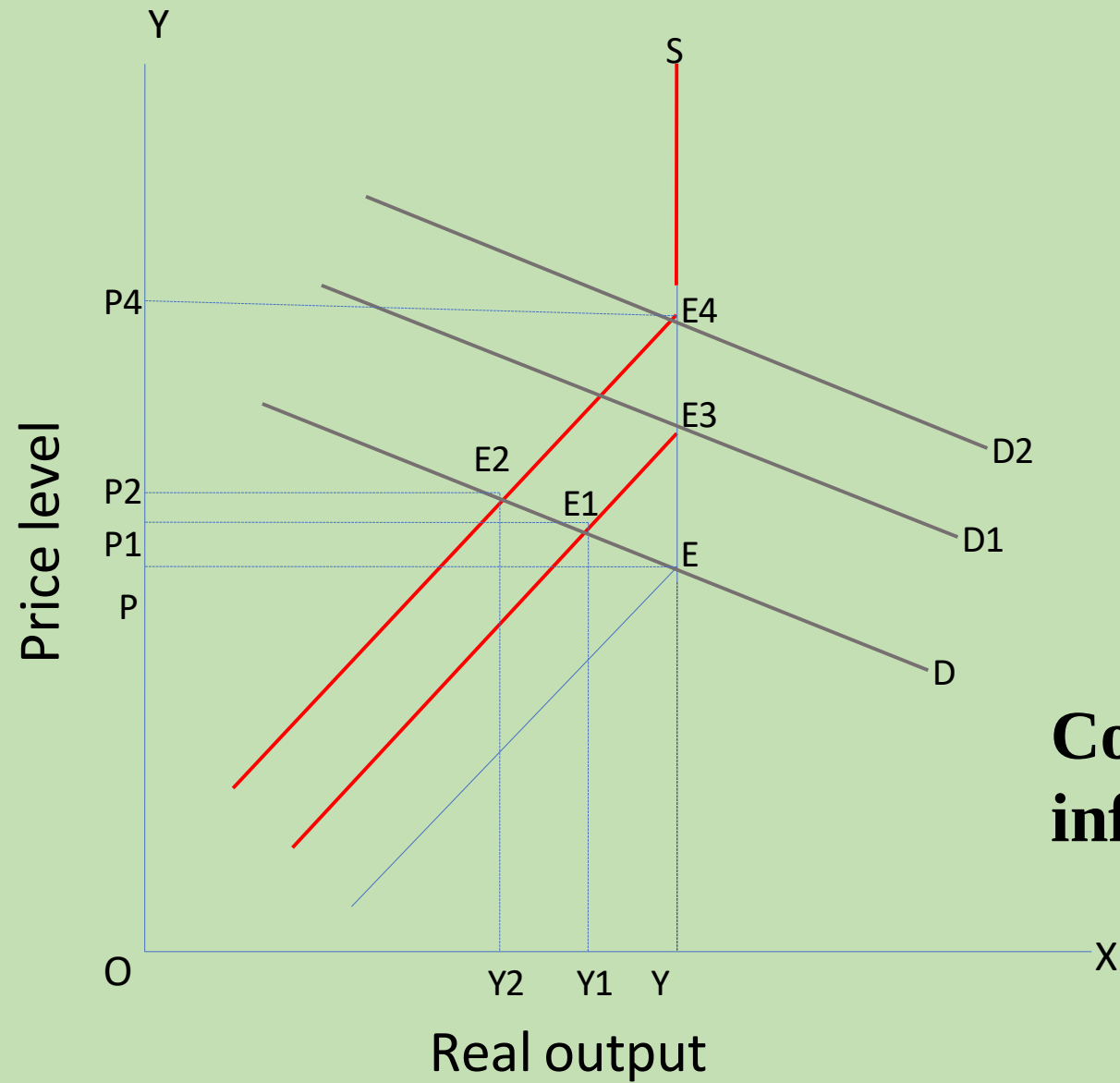
1. Increasing Money Supply
2. Deficit Finance
3. Credit Creation
4. Exports
5. Repayment of Public Debt
6. Black Money
7. Population

DEMAND PULL INFLATION



SUPPLY-SIDE INFLATION

- The supply side economist are of the opinion that the level of crisis may also increase due to increase in cost or supply price.
- The main factors affecting cost are wages, material cost, profits and others which have direct or indirect influence on the cost.



Cost push / supply side inflation

FACTORS RESPONSIBLE FOR COST PUSH

1. Wages
2. Material Cost
3. Increase In Profit Margin
4. Other factors

EFFECTS OF INFLATION

- Inflation, where price level increases and value of money decline affects the economic activities and people in different ways.
- There are 3 major types of effects :
 - I. Economic Effects
 - II. Social
 - III. Political Effects.

ECONOMIC EFFECTS

- Four major effects on different side which cause in inflation.
 - a) Effects on Production
 - b) Effect on Distribution
 - c) Effect on Consumption and Welfare.
 - d) Other effects
 - e) Effects on Foreign Trade

a. Effects on production

- A mild inflation has a stimulating effect on production.
- Due to slight rise in price of goods and services profit of enterprise businessman began to rise i.e. they invest more which lead to increase in employment, output & income.
- Negative effect: when the price rises faster it creates the following problems...
 - a) speculation
 - b) black marketing
 - c) hoarding
 - d) misallocation & diversion of resources
 - e) Due to excessive demand there develops a seller market.

b. Effect on distribution :

- inflation is socially undesirable. It redistribute when in the favors of the rich at cost of poor.
- fix income group suffers during inflation.
- enterprises & business community make super normal profit during inflation.
- creditors & debtors: creditors lose & debtors gain benefits.
- farmers get benefits during inflation.
- fixed interest earners, Small savers, investors & those who earn rent lose during inflation.

c. Effects on consumption & welfare :

- A large inflation results in fall in consumption, lowers.
- The standard of living and welfare of the people also reduces.

D. Other Effects :

- Deterioration of SAVINGS.
- Disturbances in economic planning.
- Reduces international competitiveness.
- Irrationality of consumption.
- Too much of inflation contributes to social and political instability in the economy.

d. Effect on Foreign Trade

- when prices rise foreign demand for our goods will fall and exports will decline.
- due to high prices domestic consumers may start purchasing foreign goods and will rise.

II. SOCIAL AND POLITICAL EFFECTS

- Social tension lead to political and administrative problems.
- The govt. finds it increasingly difficult to maintain law and order.
- Inflation leads to corruption, black-marketing, smuggling, and many other social and moral evils.
- Hyper inflation brings down the public morale .
- Inflation affects every section of the society.
- The nature of effects depends on the severity of the inflation.

Measures To Control Inflation

- Inflation must be controlled at an appropriate level.
- The rate of inflation was 10% from 1991 to 1996, it was effectively controlled and inflation continued to be around 6% to 7% in last one and half decade.
- The RBI and govt. are trying to control crisis by increasing supply of goods and services and also by increasing prime lending rate.
- From last one year inflation is rising & today it stands at 9.90% rate which almost close to double digit inflation.

Measures to control inflation

1. Monetary Measures
2. Fiscal Measures
3. Direct Measures
4. Other Measures

Video links

<https://www.youtube.com/watch?v=XqA27kgR2xc>

<https://www.youtube.com/watch?v=26tlbP6LGVo>

<https://www.youtube.com/watch?v=6rT5S-4bvKQ>