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Address:-Ashok Yakkaldevi 258/34, Raviwar Peth, Solapur - 413 005 Maharashtra, India
Cell : 9595 359 435, Ph No: 02172372010 Email: ayisrj@yahoo.in Website: www.isrj.net

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ORIGINAL ARTICLE

INFLATION NATURE, CAUSES, EFFECT AND CONTROL IN INDIA

EKURKEKAR BALAJI MADHUKAR

Head Dept of Economics,
V.P.S.P.M.S. Arts, Science & Commerce College,
Kannad Dist: Aurangabad .

Abstract:

The simplest and most useful definition seems to be that inflation is a state in which the value of money is falling, i.e. prices are rising. Inflation is usually associated with rising activity and employment. Inflation exists when money income is expanding more than in proportion to income earning activity". Developing countries in their bid to raise the standards of living of their people through development plans have often found themselves in the grip of inflation. By inflation we mean a general rise in prices. To be more correct, inflation is a persistent rise in the general price level rather than a once -for-all rise in it. On the other hand, deflation represents persistently falling prices. These days all the economies of the world, under developed as well as developed, suffer from inflation. Inflation or persistently rising prices is a major problem in world today. Two important features of recent inflation in various countries of the world are noteworthy. First, the rate of inflation in recent year during tenth and eleventh century has been very high as compared to the rates of inflation experienced earlier during peace periods. In some countries rate of inflation has been 14 percent per annum during the recent years. Second, in sharp contrast to the earlier periods, inflation in recent year coexists with a high rate of unemployment. The occurrence of inflation along with a high rate of unemployment is a new phenomenon and has made it difficult to control rising prices

1.INTRODUCTION:

Many economist discussed on the relationship between quantity of money and price level in economic theory. In present paper I am trying to explain the nature, causes and effect of inflation. By inflation we mean a general rise in prices. To be more correct, inflation is a persistent rise in the general price level rather than a once -for-all rise in it. On the other hand, deflation represents persistently falling prices. These days all the economies of the world, under developed as well as developed, suffer from inflation. Inflation or persistently rising prices is a major problem in world today. Two important features of recent inflation in various countries of the world are noteworthy. First, the rate of inflation in recent year during tenth and eleventh century has been very high as compared to the rates of inflation experienced earlier during peace periods. In some countries rate of inflation has been 14 percent per annum during the recent years. Second, in sharp contrast to the earlier periods, inflation in recent year coexists with a high rate of unemployment. The occurrence of inflation along with a high rate of unemployment is a new phenomenon and has made it difficult to control rising prices. Let me focus how the inflation originates or what causes it depending upon the specific causes, three types of inflation have been distinguished:

2.OBJECTIVES OF PAPER:

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To discus concept of inflation.
To focus on impact of inflation.
To focus on control of inflation.

3.DEFINITION:

1.“The simplest and most useful definition seems to be that inflation is a state in which the value of money is falling, i.e. prices are rising. Inflation is usually associated with rising activity and employment.”
By- G. crowther (An outline of money, London, 1962)
2.“Inflation exists when money income is expanding more than in proportion to income earning activity”.
By- A.C. Pigou
3.“Inflation may be defined as a state of disequilibrium in which a contraction of purchasing power trends to cause, or is effect of a decline in the price level”.
By-Paul Einzig.
4.“It is a serious error of theoretical approach to inflation, in as much as the conditions to which these definition call attention could exist without there being any inflation in the sense of a sustained rise in prices”.

By-Harry G.Johnson (Monetary Economics.)

Martin Bronfenbrenner and Franklyn D. Holzman in their famous survey article on 'Inflation Theory' have suggested the following alternative definition of inflation to those who may be reluctant to accept the evidence of price indices per se.

1.“Inflation is a condition of generalized excess demand in which too much money chases too few goods”.
2.Inflation is a rise of the money stock or money income, either total or per capita.
3.Inflation is a rise in price levels with additional characteristics or conditions: it is incompletely anticipated, it leads to further rises, it does not increase employment and read output, it is faster than some safe rate, it arises from the side of money, and it is measured by prices net of indirect taxes and subsidies, and for it is irreversible.
4.Inflation is a fall in the external value of money as measured by foreign exchange rates, by price of gold or indicated by excess demand for gold or foreign exchange at official rates.

4.TYPES OF INFLATION:

1.Demand-pull inflation.
2.Cost-push inflation.
3.Structural inflation.

I will try to explain these three types of inflation.

1.Demand-pull inflation:

This represents a situation where the basic factor at work is the increase in aggregate demand for output either from the household or the government or the entrepreneurs. The result is that the pressure of demand is such that is cannot be met by the currently available supply of output. If for example, in a situation of full employment the government expenditure or private investment goes up, this is bound to generate an inflationary pressure in the economy. This is because beyond full-employment aggregate supply or output cannot increase in response to increase in demand. This results in rise in prices under the pressure of excess demand.

2.Cost-push inflation:

We can visualize a situation where even though there is no increase in aggregate demand, prices may still rise this may happen if the costs, particularly the wage costs, go on rising. Now, as the level of employment increases, the demand for workers rises progressively so that the bargaining position of the workers is enhanced. To exploit this situation, they may ask for an increase in wage rates which are not justifiable either on grounds of a prior rise in productivity or of cost of living. The employers in a situation of high demand and employment are more agreeable to concede to these wage claims because they hope to pass on these rises in costs to the consumers in the shape of rise in prices. If this happens we have another inflationary factor at work.

3.Structural inflation:

Developing countries in their bid to raise the standards of living of their people through development plans have often found themselves in the grip of inflation.

Poverty and unemployment in under-developed economies are due to the dearth of real capital. In these countries, level of national income can be removed by accumulating more real capital. But increase in the rate of capital formation requires stepping up the level of investment. Now, under-developed countries under their development plans are making huge investment expenditure to increase the rate of capital formation and thus to obtain rapid economic growth. This huge investment expenditure leads to a sharp increase in aggregate demand for consumers goods; especially the agricultural products. Since in under-developed countries there is no excess capacity in the system. The supply of consumer's goods cannot be increased sufficiently to match the increase in demand for them. This leads to inflationary rise in prices.

4.Features of Inflation in India:

There are three main features of inflation.

a.It is a process of rising prices.
b.It is initiated by some change which makes it impossible to satisfy. The whole of demand which is forthcoming at existing prices, so that initial price rises occur.
c.It is propagated by the reaction of buyers or group of buyers to the initial price rise so that further rise in prices is induced.

5.ECONOMIC EFFECT OF INFLATION:

In analyzing the effects of inflation, the rate at which the general price level rises has always to be kept in mind, because the generalization valid inrespect of mind creeping inflation may turn out to be totally incorrect in case of hyper-inflation. In hyper-inflation there is persistent phenomenal rise in the price level. This invariably results in complete chaos in economy. Not only that during hyper-inflation no one is benefited, the whole economy is also completely shattered. On the contrary mild creeping inflation helps in maintaining the economy at full employment level. In underdeveloped countries, where mobilization of resources is a difficult task, inflation helps in raising resources which will not be otherwise available. But in these countries too, a hyper-inflation will upset the whole planning system, and the process of economic development many come to a halt.

1.The Effect of Inflation on Income Distribution:

In any economy, individuals belonging to various groups do not have identical interests and thus impact of inflation is unevenly felt by them. The people, whose real incomes erode during, are the victims of inflation. Other who manage to enhance their real incomes as the general price level rises benefits from inflation, (a) Those persons gain from inflation because prices at which goods sell rise more rapidly than their costs of production. (b) When wage contracts contains are strong enough to secure full neutralization of price rise in the form of wage increases, inflation does not hurt workers. In all other cases, inflation adversely affects wage and salary earners. (c) Inflation thus generally hurts the retired aged in all societies, but the blow may be for more severe in less developed economies due to complete absence of escalator provisions in the pension scheme of these countries. (d) It may thus be generalized that those who invest in equities are likely to benefit during inflation while recipients of fixed incomes in the form of interest from financial investment are hurt by inflation. (e) Thus there occurs a redistribution of income from creditors to debtors during the inflation one group gains income and the other loses income. (f) The recipients of income from rents are hurt only when their amounts of rent are fixed by long terms contracts. In all other cases, landlords manage to raise nominal rents to fully neutralize the decline in the value of money due to inflation.

2.The effect of inflation on the distribution of wealth:

In order to find out whether a household has benefited from inflation or is hurt from it, it is necessary to consider changes in both money income and wealth together with the changes in the price level. However, the following generalization can be made. (a) A household whose money income and wealth both rise faster than the price level surely gains from inflation, while the one whose money income and wealth both rise slower than the price level is a clear cut loser. (b) As a household wealth or net worth is the difference between the value of its assets and debts, its wealth will be adversely or favorably affected by inflation depending primarily on how its assets are divided between variable-price assets and fixed-claim assets and on how large its fixed-claim assets are relative to its debts which are all fixed claim.

3.The effect of inflation on output and employment:

How will inflation affect output and employment cannot be said a priori. However, there are economists who often assert that a mild dose of inflation will be beneficial to an economy operating at a level lower than full employment. This may be largely true for economies where wage rates do not rise as rapidly as the commodity prices. In those cases profits of the producers increases and they attempt to expand their output with the expectation that in the future they would reap much more profits. This may also happen if inflation is unanticipated. In the event of unanticipated inflation, prices rise faster than money wage rates. This naturally provides incentive to business to employ more workers and expand the output. This advantage is not available in case of anticipated inflation because wage rates get regularly adjusted with the price rise. It may thus be stated that if inflation leads to improvement in allocation of resources, the resources employed will turn out greater total output and employment than otherwise.

6.CONTROL OF INFLATION:

Most economists today believe that a capitalist society firmly committed to achieve full employment must learn to achieve full employment must learn to achieves full employment must learn to live with creeping inflation. But their dilemma is that over time creeping inflation has a tendency to acquire a speed which may have disastrous consequences for everyone in the society. R.G. Hawtrey has very aptly remarked, “If inflation is allowed to gain a footing, it is only likely to get out of control.” Yet in the post Second World War period faced with a difficult choice between major depression and inflation, the whole capitalist world opted for inflation today when inflation appears to be getting out of control, certain anti-inflationary measures are being adopted. Broadly speaking anti-inflationary measures are five:

(i)Monetary Measures: Now in almost all countries, central bank enjoys extensive powers to introduce various monetary measures to control inflationary price rise. These measures include the bank rate policy, open market operation; variable cash reserve ratio and selective credit controls.
(ii) Fiscal Measures: Since government spending in almost all countries developed and undeveloped- by changing its expenditure in relation to its tax receipts, the government can exert a powerful effect on the flow of money, aggregate demand and economic activity.
(iii)Wage Control: The wage control is a measure to deal with the cost push inflation occurring when the money wage rate rises faster than the productivity of labour. However, wage controls are generally arbitrary and difficult to implement.
(iv)Price Control: Inflation being always and everywhere a monetary phenomenon, the responsibility for controlling it is governmental. Legally enforced price and wage ceiling do not eliminate inflationary pressure. At most they suppress it. And suppressed inflation is vastly more harmful than open inflation. Guidepost and Pleas for voluntary compliance are a halfway house whose only merit is that they can more readily be abandoned than legally imposed controls. They are not an alternative to other effective measures to stem inflation, but at most a smoke-screen to conceal lack of action”.
(v)Indexation: Indexation is a method whereby such adjustments in monetary return are made that are necessary to set off losses in real incomes due to inflation.

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