Inflation - Types, Causes, Measurement and Effects

. Introduction –

Inflation can be defined as :

- A rise in Price level
- The general level of prices of goods and services
- In an economic over a period of time

Fall in the value of money When the level of currency of a country exceeds the level of production, inflation occurs.
Value of money depreciates with the occurrence of inflation.

In case the general price level rises :

- Each unit of money / currency
- Buys fewer goods and services .
- Consequently inflation also reflects erosion in the purchasing power of money.

Example –

- J In 2014 1 Kg of Rice = Rs 40
- J In 2016 1 Kg of Rice = Rs 60

The above increase in price of wheat . The purchasing power of money has decline as the same amount of good is available at higher price

Hence , the above price rise of wheat over a period of time is called as inflation that is affecting the purchasing power of the people
This in turn reduces the value of money as for each commodity we have to spend more than the previous one .

Definition -

- "Inflation is State in which the Value of Money is Falling and the Prices are rising."
- In Economics, the Word inflation Refers to General rise in Prices Measured against a Standard Level of Purchasing Power.

Types of Inflation –

Explication -

- **Demand Pull Inflation –** Inflation created and sustained by excess of aggregate demand for goods and services over the aggregate supply . In other words , demand pull inflation takes place when increase in production lags behind the increase in money supply
- **Cost Pull Inflation –** Inflation which is created and sustained by increase in cost of production which is independent of the state of

demand (e.g. Trade unions can bargain for higher wages and hence contributes to inflation)

- **Stagflation –** In this types there is fall in the output and employment levels . Due to various pressure , the entrepreneurs have to raise price to maintain their margin of profits . But as they only partially succeed in raising the prices , they are faced with a situation of declining output and investment . Thus on one side there is a rise in the general price level and on the other side there is a fall in the output and employment .
- **Open Inflation -** The rate where Costs rise due to Economic trends of Spending Products and Services.
- **Suppressed Inflation -** Existing inflation disguised by government Price controls or other interference in the economy such as subsidies. Such suppression, nevertheless, can only be temporary because no governmental measure can completely contain accelerating inflation in the long run. It is Also Called Repressed Inflation.
- **Galloping Inflation -** Very Rapid Inflation which is almost impossible to reduce.
- **Creeping Inflation -** Circumstance where the inflation of a nation increases gradually, but continually, over time. This tends to be a typically pattern for many nations. Although the increase is relatively small in the short-term, as it continues over time the effect will become greater and greater.
- **Hyper Inflation -** Hyperinflation is caused mainly by excessive deficit spending (financed by printing more money) by a government, some economists believe that social breakdown leads to hyperinflation (not vice versa), and that its roots lie in political rather than economic causes.

Causes of Inflation -

Factors on Demand Sides –

- Increase in money supply
- Increase in Export
- Increase in disposable income
- Deficit financing
- Foreign exchange reserves

Factors on Supply Side –

- Rise in administered prices
- Erratic agriculture growth
- Agricultural price policy
- Inadequate industrial growth

Black money (fake currency)
Increase in public expenditure
Decrease in the aggregate supply of goods and services

Effect of Inflation –

- They add inefficiencies in the market, and make it difficult for companies to budget or plan long-term.
- Uncertainty about the future purchasing power of money discourages investment and saving.
- There can also be negative impacts to trade from an increased instability in currency exchange prices caused by unpredictable inflation.
- Higher income tax rates.
- Inflation rate in the economy is higher than rates in other countries; this will increase imports and reduce exports, leading to a deficit in the balance of trade.

Measurement of Inflation –

The 2 ways of Measuring Inflation are –

1. CPI
2. PPI

- Inflation is measured by general prices index . General price index measures the changes in average prices of goods and services . A base year is selected and its index is assumed as 100 and on this basis price index for the current year is calculated . If the index of the current year is below 100 , it indicates the state of deflation and , on the contrary , If the index of the current year is above 100 it indicate the state of inflation
- Inflation rate and the value of money (Or the purchasing power of money) are inversely correlated . Hence , the value of money can also be measured with the help of price indices . The value of money declines when price index goes up and Vice-Versa.

Consequences of Inflation –

- Adverse effect on production
- Adverse effect on distribution of income
- Obstacle to development
- Changes in relative prices
- Adverse effect on the B.O.P (Balance of Payment)

Measures of Inflation –

Monetary policy

- Credit Control
- Demonetization of Currency
- Issue of New Currency

Fiscal policy

- Reduction in Unnecessary Expenditure
- Increase in Taxes
- Increase in Savings
- Surplus Budgets
- Public Debt

Other Measures

- To Increase Production
- Rational Wage Policy
- Price Control

Inflation a threat to Indian economy -

- Inflation has become a household name for millions of Indians who are finding it extremely difficult to make both ends meet. Prices are growing faster than the household income almost for all products and services including real estate, food, transportation, luxuries.
- The global economic crisis saw many economies stumble but India rebounded faster and was surging ahead with a growth rate of 9%. But the inflationary pressure is forcing the government to adopt

measures which are taking the steam out of the Indian growth story

- For the last two years India is witnessing double digit food inflation which had reached a high of around 18% in December 2010 with prices of onions, garlic and tomatoes skyrocketing. Lentils, milk and meat have witnessed a steady rise in prices which is putting pressure on the home budget of millions of Indians.
- Millions of poor people in India are struggling to arrange a two-square meal for their family members. We are running the risk of having an entire generation of malnourished children who are otherwise considered the future of India.
- The tightening of the economy may control inflation in the long run but it is also slowing our economy and as predicted by the IMF India's growth will be only around 6-7% instead of 9%.

Current status of inflation in India –

- Currently inflation rate is around 9.44% in India, much above the acceptable rate of 5%.
- The food price index is at 8.31% causing much discomfort to the policymakers. which under the current scenario seems impossible.

How to Control Inflation –

Monetary Measures –

- Credit Control
- Issue of new currency

Fiscal Measures –

- Reduction in Unnecessary Expenditure
- Increase in taxes
- Increase in savings
- Surplus Budgets
- Public Debts
- To increase in production
- Rational wage policy
- Price control
- Rationing