

Chapter - 8

Unit - 7

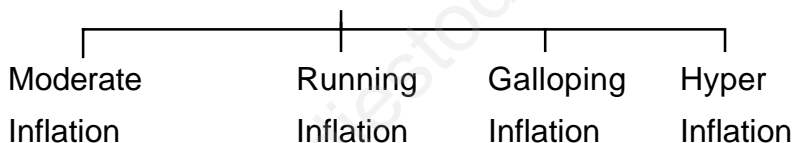
Inflation : Problem and Policies

By inflation in ordinary language, we mean a process of rising prices. Inflation is a situation of persistent and appreciable rise in prices, leading to fall in purchasing power of money. A chief measure of price inflation is the inflation rate, the annualized percentage change in a general price index over time.

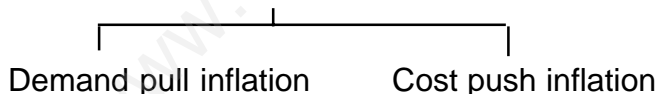
Types of inflation

There are many types of inflation on different grounds.

1. According to the rate inflation



2. On the basis of cause of origin :



Demand Pull Inflation : Demand -pull inflation arises when there is an excess of demand for goods over their supply. When is a persistent increase in demand and supply does not increase proportionately, then price tends to rise. The main causes of demand pull inflation are :

- * Increase in public expenditure.
- * Increase in investment
- * Increase in money supply
- * Growth in black money
- * Increase in population

Cost push inflation : Cost push inflation occurs when rise in price is due to rise in the cost of production. In this type of inflation, demand factor plays an important and supply factor plays an important role. Once, this type of inflation sets in one industry, it spreads to all other industries of an economy.

Main causes of cost-push inflation are :

- * Higher wage rate
- * Higher profit margin
- * Higher taxes
- * Fall in the availability of basis inputs.
- * Administered higher prices of inputs.

Causes of Inflation

1. Demand factors
 - * Growth of population
 - * Rise in employment and income
 - * Increase in pace of urbanisation.
2. **Supply factors**
 - * Irregular agricultural supply
 - * Hoarding of essential goods.
 - * Rise in administered prices.
 - * Agricultural price policy
 - * Rising prices of imports
 - * Inadequate growth of industrial production.
3. **Monetary and fiscal factors**
 - * Rising levels of government expenditures.

- * Deficit financing.

Effect of Inflation

Micro - on Individual

- * Real income declines
- * Wealth value declines
- * Income redistribution causes social tensions.

Macro - on Economy

- * Hoarding and black marketing.
- * Speculation increases
- * Nominal pay increase
- * Higher tax bracket.
- * Deterioration of quality of goods and standard of living.

Policy measures to control inflation

Monetary measures

- * Raising bank rate
- * Raising cash reserve ratio and statutory liquidity ratio.
- * Open market operations

Fiscal Measures

- * Reverse policy
- * Expenditure policy

Physical or non monetary measures

- * Increasing output or increasing inputs
- * Controlling money wages
- * Price control and rationing.

01 MARK QUESTIONS

1. Define inflation
2. Define deflation
3. Define stagflation
4. Which demand factors cause inflation?
5. Which supply factors cause inflation?
6. What is demand pull inflation?
7. What is cost push inflation?
8. What is inflation rate?
9. Who controls and monitor monetary policy india?
10. What is fiscal policy?

SHORT ANSWER QUESTIONS (03-04 MARKS)

1. Explain demand pull inflation.
2. Explain monetary measures to control inflation.
3. Explain fiscal measures to control inflation.
4. What are the various types of inflation?
5. What are supply factors which cause inflation?
6. What are the major impact of inflation on the economy?

LONG ANSWER QUESTIONS (6 MARKS)

1. What is demand pull inflation? What are its causes?
2. What is cost push inflation. What are its causes?
3. What have been general causes of inflation in India?
4. What are the measures taken by the government to tackle inflation?
5. What is the impact of inflation on the economy?

ANSWERS OF 01 MARK QUESTIONS

1. Inflation is a situation of persistent and appreciable rise in prices, leading to fall in purchasing power of money.
2. Deflation is a situation where prices are falling and value of money is rising.
3. Stagflation means stagflation plus inflation. It is a situation where stagnation co- exists with inflation in an economy.
4. Growth in population, rise in employment and increasing pace of urbanisation cause inflation.
5. Hoarding of essential goods, irregular agricultural supply, rise in administered prices and inadequate growth of industrial production are some of the supply factors which cause inflation.
6. Demand pull inflation arises when there is an excess of demand for goods over their supply.
7. Cost push inflation occurs when rise in price is due to rise in the cost of production.
8. Inflation rate is a chief measure of price inflation. It is annualized percentage change in a general price index over time.
9. The reserve bank of India controls and monitors monetary policy in India.
10. Fiscal policy is the expenditure and revenue policy of the government.