"Inflation: What it is? Types and Causes"

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Introduction

Inflation is one of the most crucial current macroeconomic problem for many countries of the world. In the post war II period people in almost every country in the world have been tormented by the vagaries of inflation. Prices have kept on rising year after year so much systematically that any temporary change in the direction of upward moment of prices is not easily and at once believed.

Meaning

Inflation is a highly controversial term. It has been defined differently by different economists. *Chamber's Twentieth Century Dictionary* defines inflation as an "undue increase in the quantity of money in proportion to buying power as on an excessive issue of fiduciary money". According to Kemmerer, "Inflation is too much money and deposit currency that is too much currency in relation to the physical volume of business being done." While for *Crowther*, "Inflation is a state in which the volume of money is falling i.e, prices are rising." *Gregory* associates inflation with a state of "abnormal increase in the quality of purchasing power" and Hawtrey "with the issue of too much currency". According to *Pigou*, inflation takes place when money income is expanding relatively to the output of work done by the productive agents for which it is the payment." According to *Ackley*, "inflation is a persistant and appreciable rise in general level or average of prices.". From these definitions it is obvious that inflation is a process of rising prices and not a state of high prices. Being a process of rising prices, inflation should be regarded as a state of disequilibrium and must therefore, from the subject matter of dynamic analysis. The common characteristic of all these definitions is the evidence of a state of disequilibrium between the demand for and supply of goods which causes rise in the general level of prices in the economy.

Types of Inflation

Inflation is of different types. These different types may be considered by dividing them into different catagories on different considerations. Firstly, we might distinguish between different types of inflation on the basis of degree or speed with which price rise. Secondly, we may study the problem on the basis of the different process, through which inflation is induced. In the third phase, we might also adopt the criterion of time to distinguish between different types of inflation. Fourthly inflation may be either sporadic or comprehensive. Fifthly, inflation may be open or suppressed.

On the basis of the rate at which prices in the economy rise we have: i) creeping inflation, ii) walking inflation, iii) trotting or running inflation and iv)galloping or hyperinflation.

Factors causing inflation

Inflation is caused by a variety of conditions. The most important of these are the following:-

A) Demand Pull:- The most common condition causing inflation is the pressure of rising demand on a not so rapidly increasing supply of goods and services.

1) Increase in demand which may be due to:-

a) Increase in money supply

b) Increase in disposable income

c) Increase in commodities aggregate spending on consumption and investment goods without a corresponding increase in the available goods and services.

d) Excessive speculation and tendency of hoarding and profit creating on the part of producers and traders.

e) Increase in foreign demand

f) Increase in salaries, wages or dearness allowance

g) Increase in population

h) The most important cause is excessive public expenditure financed by budget deficits during war or on the implementation of plants for economic development. The newly created money increases government demand for goods and also the purchasing power of the people through increase in disposable income. These causes may operate singly or in combination with one another.

2) No corresponding increase in the output of goods and services, which may be due to:-

a) Deficiency of capital equipments

b) Scarcity of other complementary factors of production, e.g. skilled labour or technicians, essential raw materials or lack of dynamic entrepreneurs.

c) Increase in exports foe earning the required foreign exchange

d) Decrease in imports owing to war or restrictions on imports necessitated by an adverse balance of payments and efforts to rectify it

e) Speculative hoarding by the producers, traders and middle man in anticipation of a further rise in prices.

f) Drought, famine or any other natural calamity adversely affecting agricultural production

g) Prolonged industrial unrest result resulting in reduction of industrial production.

The demand pull inflation caused primarily by factors operating on the demand side resulting in excess of aggregate demand over the available supply of goods and services.

B) Cost Push:- The cost push inflation is caused by an upward movements of costs of production when prices have a tendency to rise, trade union activity often brings about an increase in the wage rates of labour. When the labour is strongly organised, the demand for higher wages may be irresistable and there may be rise in wage without a corresponding increase in productivity of labour. There is therefore a further rise in the prices of machinery and capital equipment and of essential new material, because of increasingly demand caused by rising wages.

C) Demand Shift:- There is often an inflationary rise in prices without there being a general increase in demand. The increase in demand may confined to an important sector of the economy. For example, a rise in wages in some industries causes prices to rise there, but there the moment spreads to other industries are also pushed up. The rise in prices then spreads all over the economy. This may also happen due to an initial rise in the prices of raw-materials, components ect. In India, rising prices are often strengthen by rises particularly in the prices of food stuffs.

The shift of demand from one sectors to others is particularly active because prices are often flexible upward but rigid downward. So there excess demand but there is a rise in prices in industries where there is no fall of prices in other industries and there may be excess supply. Sooner or latter, however, prices all over the economy may assume a upward trend.

D) Other conditions:- A further condition creating inflationary pressure in the economy is the encouragement to hoarding and speculation caused by shortage of various commodities. When prices are rising and there are shortages all around, dealers are often tempted to withhold stocks from markets in the expectation of higher prices than are * at any particular time. The demand on the part of purchases goes up even higher than is justified by the available disposable income because they are tempted to buy goods before the prices rise further. There is, thus a strong inclination on the parts of purchases to buy and on the other part of sellers not to sell, adding to the inflationary pressures already existing.

Conclusion

While concluding we can say inflation (also termed as price rise) is a state of rising prices, when the value of money falls and is caused when the aggregate demand exceeds aggregate supply of goods and services. We have analysed the factors which lead to increase in demand and shortage of supply.