TITLE –

MEANING AND EXPLANATION OF " HYPERINFLATION" AND "INFLATIONARY GAP"

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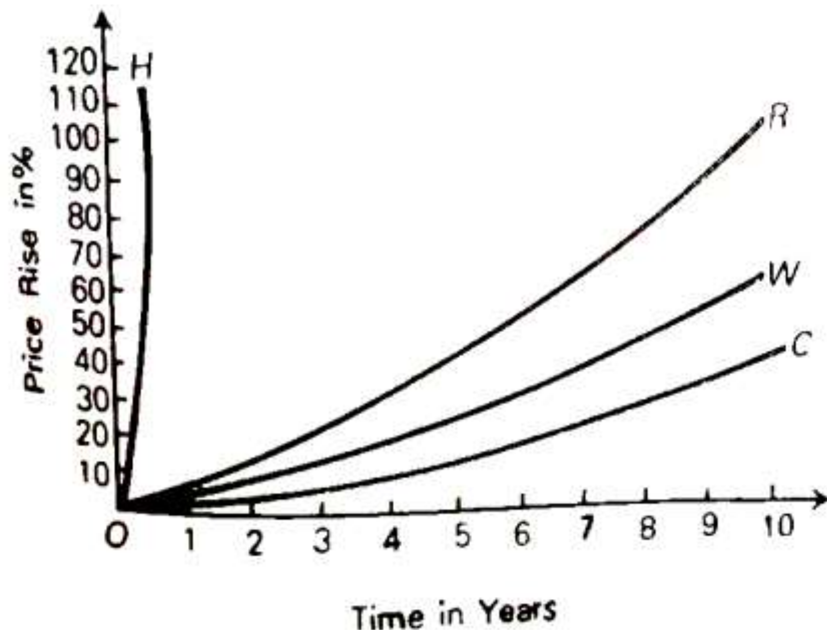
Hyperinflation

In Economics. hyperinflation is very high and typically accelerating inflation.

When Prices rise very fast at double or triple digit rates from more than 20 to 100 percent per annum or more, it is usually called run away or galloping inflation. **It is characterized as hyperinflation by certain economists**. In reality hyperinflation is a situation when the rate of inflation becomes immeasurable and absolutely uncontrollable. Prices rise many times everyday. Such a situation brings a total collapse of the monitary system because of the continuous fall in the purchasing power of money.

The speed with which prices tend to rise can be illustrated with a Fig.



The Curve '**C**' shows creeping inflation when within a period of 10 years the Price level has been shown to have risen by about 30 percent. The Curve '**W**' depicts walking inflation when the price rose by more than 50 percent during 10 years. The Curve '**R**' illustrates running inflation showing a rise of about 100 percent in 10 years. **The steep curve 'H' shows the path of hyperinflation** when prices rose by more 120 percent in less than 1 year.

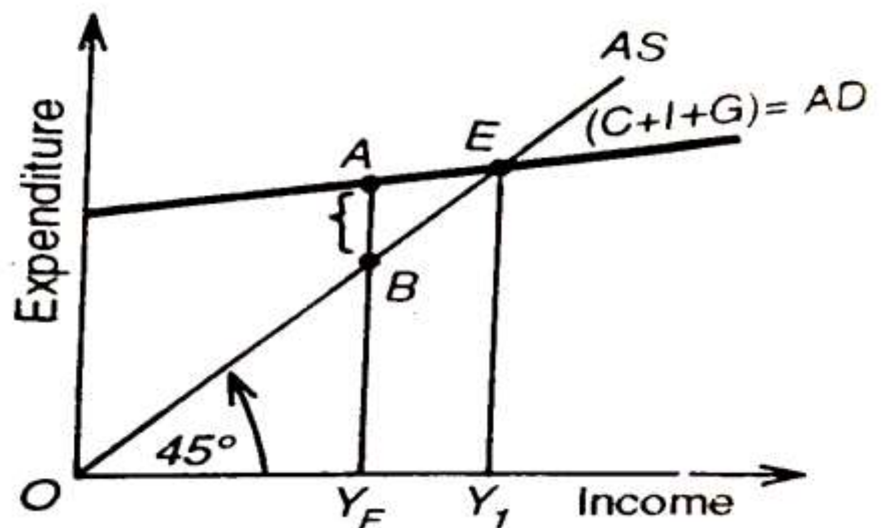
Hyperinflation is often associated with some stress to the government budget, such as wars or their aftermath, sociopolitical upheavals, a collapse in aggregate supply or one in export prices, or other crisis that make it difficult for the government to collect tax revenue. A sharp decrease in real tax revenue coupled with a strong need to maintain Govt. Spending, together with an inability or unwillingness to borrow, can lead a country into hyperinflation.

Inflationary gap

Keynes invented the term " inflationary gap " to describe a situation when there is " excess of anticipated expenditures over the available output at base prices." It therefore indicates an excess of the total demand for goods over their total available supply at constant prices. We might look at it in relation to the full employment level of income and define an inflationary gap as the excess of the aggregate money spending over the aggregate output at full employment level at the current level of prices. In a simple words, it is a gap between money incomes of the community and the available supply of output of goods and services.

Inflationary gap arises when consumption and investment spending together is greater than the full employment GNP level. This means that people are demanding more goods and services than can be produced. In other words, the implication of inflationary gap is that national income, output and employment cannot rise further. The only consequence of increased demand for goods and services on the part of people will be to raise the price level, or, we may say that there will be an inflationary gap is scheduled investment tends to be greater than full employment saving. In a situation like this, more good will be demanded than the economic system can produce. The result will be that the prices will begin to rise and inflationary situation will emerge. Thus, if full employment savings falls, short of scheduled investment at full employment, there will be an inflationary gap.

This can be represented by the following diagram.



In this diagram **Y_F** is the full employment level of income, **45°** line represents aggregate supply **AS** and **(C+I+G)** line the desired level of consumption, investment and government expenditure (or aggregate demand curve). The economy's aggregate demand curve **(C+I+G)=AD** intersects the 45° line (AS) at point **E** at the income level **OY_1** which is greater than the full employment income level **OY_F**. **The amount by which the aggregate demand (Y_FA) exceeds the aggregate supply (Y_FB) at the full employment income level is the inflationary gap. This is AB in the figure.** The excess volume of total spending when resources are fully employed creates inflationary pressures. Thus the

inflationary gap leads to inflationary pressures in the economy which are the result of excess aggregate demand.

How can the Inflationary gap be wiped out ?

A govt. may choose to use **fiscal policy** to help reduce an inflationary gap, often through decreasing the number of funds circulating within the economy. This can be accomplished through reductions in govt. spending, tax increases, **bond and securities** issues, interest rate increases and transfer payment reductions. These adjustments to the fiscal conditions within the economy can help restore economic equilibrium. Monetary policy can also be used to decrease the money stock. But Keynes was not in favours of monetary measures to control inflationary pressures within the economy.

Criticisms :- The concept of Inflationary gap has been criticized by Friedman, Koopmans, Hansen and other economists.

1. The analysis of inflationary gap is based on the assumption that full employment prices are flexible upward which leads to the mixing up of demand and cost inflations.
2. It is confined with goods market only, and neglecting the role of the factor market.
3. The inflationary gap is a static analysis. But the inflationary phenomena are dynamic.
4. Another weakness is that it is related to flow concepts.
5. More over Keynes has been criticized for applying the multiplier technique to a full employment situation. In a full employment situation, the share of one group in the national output can only be increased at the expense of another.

It is worth mentioning that despite the above criticisms, the concept of **Inflationary gap** has proved to be of much importance in explaining rising prices at full employment level and policy measure in controlling inflation.