Inflation

Imp According to keynes, inflation is defined
" A rise in price level which comes into existence after stage of full employment."

When there is expansion of money, it will lead to rise in production then a rise in employment it will continue untill all men are employed till Full employment is achieved. Beyond it even if vol. of money increases there will be no effect on production and employment. Rise in prices after the stage of Full employment is bad for country. Since there is no corresponding increase in production.

There are two types of rise in prices :-

1. Rise in prices accompanied by increase in prodn.
2. Rise in prices not accompanied by such an increase in output.

- Kinds of Inflation :-

1. Demand - Pull Inflation → It occurs when price level rises because of an inbalance in aggregate demand and aggregate supply. It is the result of strong consumer demand when many individuals are trying to purchase same good, price will inevitably increase

The most common cause of inflation is the pressure of ever-rising demand on a stagnant or less rapidly increasing supply of goods and services. The expansion in aggregate demand may be the result of rapidly increasing pvt. investment and/or expanding govt. expenditure for war or for economic development. Thus, inflationary pressure may be built up by aggregate demand increasing much in excess of the available resources. The increase in aggregate demand may be due to increase in Govt. expenditure or increase in pvt. Investment and private consumption, release of pent-up demand of consumers immediately after a war, increase in exports, and so on. Deficit financing and increase in money supply further aggravate the situation by boosting demand still further. In all these cases, inflation is the result of demand-pull factors. It must be emphasised here that demand-pull inflation cannot be sustained unless there is increase in money supply.

2. Cost-Push Inflation → Cost push inflation is caused by wage push and profit push to prices. In certain circumstances, prices may be pushed up by wage increases forced upon the economy under threat of strike by labour leaders. Costs can also be raised by manufacturers through a system of fixing a higher profit margin. Under conditions of rising prices business and units find it easy to pass on the burden of higher wages to the consumers by raising prices. Thus, rise in wages, in profit margins and in taxation - all these are responsib

for cost-push inflation.

Reasons for cost-push inflation :-

(i) In advance countries trade unions are very powerful they press employers to grant wage increase considerably in excess of increase in productivity of labour. So, cost of production increases, employers raise the price of product. Higher wages enable to buy as much as before.

(ii) Sectorial rise in prices → In many cases, production such as steel, raw material etc are used as input for production of commodities. As a result, Production cost of other sectors will rise and push up the prices of their products.

(iii) Rise in prices of imported raw material → An increase in prices of imported raw material may lead to cost push inflation. Raw materials are used as inputs by manufacturers of finished goods & they enter into cost of production.

- Kinds of Inflation on the basis of rate :-

1. Creeping Inflation :- Rise in prices is very slow like that of Snail. Annual increase is less than 3% p.a.

2. Walking & trotting Inflation :- Rate of rise in prices is in between 3 to 6 % or less than 10 %

3. Running Inflation :- Price rise rapidly. The rate is between 10-20 % p.a. It affect poor & middle class