

Inflation, causes and solutions



**ASSIGN
BUSTER**

INFLATION : A sustained rise in the prices of commodities that leads to a fall in the purchasing power of a nation is called inflation. Although inflation is part of the normal economic phenomena of any country, any increase in inflation above a predetermined level is a cause of concern. How is inflation measured Inflation in India is measured through a WPI (wholesale price index) .

In India, the wholesale price index (WPI), rate consisted of three main components – primary articles, which included food articles, constituting 22% of the index; fuel, constituting 14% of the index; and manufactured goods, which accounted for the remaining 64% of the index Today this is around 8 % in india which is very high . Last year this touched double digit figures at 10% . Cause of inflation – General theory * printing of more money by the government, * a rise in production and labor costs, * high lending levels, a drop in the exchange rate Demand Pull theory a rise in prices due to * increase in demand in excess of the supplies * An increase in the quantity of money in circulation relative to the ability of the economy to supply leads to increased demand, thereby fuelling prices. The case is of too much money chasing too few goods. * An increase in demand could also be a result of declining interest rates, * a cut in tax rates or increased consumer confidence. The Cost Push theory, Inflation occurs due to increase in production cost .

The cost of production can rise because of * rising labor costs * when the producing firm is a monopoly or oligopoly and raises prices * cost of imported raw material rises due to exchange rate changes, * external factors, such as natural calamities * an increase in the economic power of a

certain country. * An increase in indirect taxes A classic example of cost-push or supply-shock inflation is the oil crisis that occurred in the 1970s, after the OPEC raised oil prices. The US saw double digit inflation levels during this period.

Since oil is used in every industry, a sharp rise in the price of oil leads to an increase in the prices of all commodities. Indian scenario The average annual GDP growth in the 2000s was about 6% and during the second quarter (July-September) of fiscal 2006-2007, the growth rate was as high as 9.2%. All this growth was bound to lead to higher demand for goods. However, the growth in the supply of goods, especially food articles such as wheat and pulses, did not keep pace with the growth in demand. As a result, the prices of food articles increased.

According to Subir Gokarn, Executive Director and Chief Economist, CRISIL, “The inflationary pressures have been particularly acute this time due to supply side constraints [of food articles] which are a combination of temporary and structural factors.” Causes of Price Rise in INDIA Inflation is bringing us true democracy. For the first time in history, luxuries and necessities are selling at the same price. There cannot be any single cause for price rise of essential commodities continually over the years. 1. Growth in demand due to Population growth The inflationary pressure on the i economy partly through imbalance in demand and supply.

The ever increasing demand has been primarily due to our ever increasing and bulgeoning population. Even a few decades ago it used to be around 12 to 14 million every year which has gone up to nearly 20 million every year.

This increase in population automatically creates an increased demand for food and essential commodities which results in a persistent gap between demand and supply in almost all consumer goods and services. It is indeed unfortunate that we have not been able to evolve a fixed and common norm to check the spiraling population, something which China has been able to achieve.

Our politicians, monetarists and structuralists have chosen to ignore or underplay the effect of this growth on prices. India has several problems besides inflation, all affecting the citizens and creating more disparity between the rich and poor but no problem can be solved satisfactorily unless the growth of population is checked. 2. Government expenditure Mounting government expenditure over the years has also been responsible for inflation. The total expenditure of Central and State government in 1950-51 was about Rs. 750 crores only. This expenditure went up to Rs. 37,000 crores in 1980-81, further up to Rs. 5,80,000 crores in 2000-2001.

Much of this has been non-development expenditure implying an increased income in the hands of general public and stoking the fires of inflation. The populist measures of doubling and trebling salaries of government employees without implementing the rest of the recommendations of the pay commission has put an excessive burden on the exchequer without deriving any benefits from this. 3. Increased money supply due to deficit budgeting Deficit budgeting is another reason for inflation. Mounting government expenditure financed through deficits directly pushes up money supply consequently pushing up demand.

This has been responsible for the inflationary situation in the country with the State governments further adding to the problems through persistent financial indiscipline, reckless expenditures and unauthorized overdrafts. 4.

Black Money: There is considerable slush money with politicians and Government servants, mainly those dealing with licensing, registration, sales tax, trade tax, income tax etc. this slush money is used in real estates pushing up already high prices, extensive hoarding and black marketing inflation sensitive goods. The role of continual black money influx in creating inflationary pressures cannot be discounted. . **Taxation and Wages:** The increased taxes in every budget gives an opportunity for corrupt traders to further push up taxes even beyond the levy. With fat pay packets, the higher salaried class and government services do not feel the punch what with dearness allowances applicable. 6. **Procurement:** The policy of compulsory procurement by the government is another factor. With politics playing an important role in fixing procurement prices most of the time at unreasonable rates. This automatically leads to increase in prices of agricultural products.

The really serious effects of inflations are the distribution of income in india. Inflation has brought about a considerable disparity in income. The producers, traders and speculators have gained enormously through illegal gains, ever-increasing profits and windfall gains through black marketing, hoarding and speculation. But what about the working class in unorganized sectors – small establishments where wages remain constant despite continual increase in prices over the years. The middle class has now been bifurcated into the border line, the lower and the upper middle class. 7.

Other factors (natural , taxes etc) There are other various factors that contribute to this rise in prices. Some are natural factors like unfavourable weather conditions which affect the food production and lead to the shortage of commodities in the market. With more money chasing fewer goods, the prices take to the wings. Compounding this natural problem are other man-made problems like hoarding which contribute to the escalation of prices. The moment the trading community senses a shortage of certain commodities or products, especially the essential commodities; they resort to large scale hoarding.

They release the hoarded commodities after escalation of the prices and make a neat margin over their investment in the hoarded commodities. Though the government has the necessary powers to check hoarding it does not have the necessary manpower to contain the despicable acts like hoarding. Apart from the natural factors and the man-made factors like hoarding that add to the rise in prices or inflation, the government too contributes its bit to the escalation of prices by imposing higher taxes on raw materials and finished products

SUGGESTIONS FOR TACKLING INFLATION .

1. Balance government spending (austerity) and poverty alleviation program
2. Curtail leaks through transparent procurement process
3. Enact and implement strict laws on black marketing and hoarding
4. Policies to attract investment in storage and improve distribution of food items so that supply improves
5. Invest in good public transport and ensure optimum spending on oil to keep control on spending on import and currency value fluctuations
6. Generate public awareness through public campaigns, urging citizens not to waste food or other commodities