"बेटी बचाओ, बेटी पढ़ाओ"

JAYOTI VIDYAPEETH WOMEN'S UNIVERSITY, JAIPUR

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Faculty of Education and Methodology

Faculty Name- JV'n Dr. Md Meraj Alam

Program- BA (Hons) Economics 2nd Semester

Course – Macroeconomics II

Digital session name – Causes of Inflation

Inflation is caused when the aggregate demand exceeds the aggregate supply of goods and services. We analyse the factors which lead to increase in demand and the shortage of supply.

Factors Affecting Demand:

Both Keynesians and monetarists believe that inflation is caused by increase in the aggregate demand.

They point towards the following factors which raise it.

1. Increase in Money Supply:

Inflation is caused by an increase in the supply of money which leads to increase in aggregate demand. The higher the growth rate of the nominal money supply, the higher is the rate of inflation. Modem quantity theorists do not believe that true inflation starts after the full employment level. This view is realistic because all advanced countries are faced with high levels of unemployment and high rates of inflation.

2. Increase in Disposable Income:

When the disposable income of the people increases, it raises their demand for goods and services. Disposable income may increase with the rise in national income or reduction in taxes or reduction in the saving of the people.

3. Increase in Public Expenditure:

Government activities have been expanding much with the result that government expenditure has also been increasing at a phenomenal rate, thereby raising aggregate demand for goods and services. Governments of both developed and developing countries are providing more facilities under public utilities and social services, and also nationalising industries and starting public enterprises with the result that they help in increasing aggregate demand.

4. Increase in Consumer Spending:

The demand for goods and services increases when consumer expenditure increases. Consumers may spend more due to conspicuous consumption or demonstration effect. They may also spend more whey they are given credit facilities to buy goods on hire-purchase and instalment basis.

5. Cheap Monetary Policy:

Cheap monetary policy or the policy of credit expansion also leads to increase in the money supply which raises the demand for goods and services in the economy. When credit expands, it raises the money income of the borrowers which, in turn, raises aggregate demand relative to supply, thereby leading to inflation. This is also known as credit-induced inflation.

6. Deficit Financing:

In order to meet its mounting expenses, the government resorts to deficit financing by borrowing from the public and even by printing more notes. This raises aggregate demand in relation to aggregate supply, thereby leading to inflationary rise in prices. This is also known as deficit-induced inflation.

7. Expansion of the Private Sector:

The expansion of the private sector also tends to raise the aggregate demand. For huge investments increase employment and income, thereby creating more demand for goods and services. But it takes time for the output to enter the market.

8. Black Money:

The existence of black money in all countries due to corruption, tax evasion etc. increases the aggregate demand. People spend such unearned money extravagantly, thereby creating unnecessary demand for commodities. This tends to raise the price level further.

9. Repayment of Public Debt:

Whenever the government repays its past internal debt to the public, it leads to increase in the money supply with the public. This tends to raise the aggregate demand for goods and services.

10. Increase in Exports:

When the demand for domestically produced goods increases in foreign countries, this raises the earnings of industries producing export commodities. These, in turn, create more demand for goods and services within the economy.

Factors Affecting Supply:

There are also certain factors which operate on the opposite side and tend to reduce the aggregate supply.

Some of the factors are as follows:

1. Shortage of Factors of Production:

One of the important causes affecting the supplies of goods is the shortage of such factors as labour, raw materials, power supply, capital, etc. They lead to excess capacity and reduction in industrial production.

2. Industrial Disputes:

In countries where trade unions are powerful, they also help in curtailing production. Trade unions resort to strikes and if they happen to be unreasonable from the employers' viewpoint' and are prolonged, they force the employers to declare lock-outs. In both cases, industrial production falls, thereby reducing supplies of goods. If the unions succeed in raising money wages of their members to a very high level than the productivity of labour, this also tends to reduce production and supplies of goods.

3. Natural Calamities:

Drought or floods is a factor which adversely affects the supplies of agricultural products. The latter, in turn, create shortages of food products and raw materials, thereby helping inflationary pressures.

4. Artificial Scarcities:

Artificial scarcities are created by hoarders and speculators who indulge in black marketing. Thus they are instrumental in reducing supplies of goods and raising their prices.

5. Increase in Exports:

When the country produces more goods for export than for domestic consumption, this creates shortages of goods in the domestic market. This leads to inflation in the economy.

6. Lop-sided Production:

If the stress is on the production of comforts, luxuries, or basic products to the neglect of essential consumer goods in the country, this creates shortages of consumer goods. This again causes inflation.

7. Law of Diminishing Returns:

If industries in the country are using old machines and outmoded methods of production, the law of diminishing returns operates. This raises cost per unit of production, thereby raising the prices of products.

8. International Factors:

In modern times, inflation is a worldwide phenomenon. When prices rise in major industrial countries, their effects spread to almost all countries with which they have trade relations. Often the rise in the price of a basic raw material like petrol in the international market leads to rise in the price of all related commodities in a country.

Course Outcome: The goal of this paper will be to expose the students to the basic principles of macroeconomics. The emphasis will be on thinking like an economist and course will illustrate how economic concepts can be applied to analyse real-life situations. In this course, the students are introduced to money and interest, theories of inflation, rate of interest, trade cycle and growth models.