JAYOTI VIDYAPEETH WOMEN'S UNIVERSITY, JAIPUR

Government of Rajasthan established

Through ACT No. 17 of 2008 as per UGC ACT 1956

NAAC Accredited University

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 – Inflation: Meaning and Types -I

Introduction:

Inflation is a highly controversial term which has undergone modification since it was first defined by the neo-classical economists. They meant by it a galloping rise in prices as a result of the excessive increase in the quantity of money. They regarded it "as a destroying disease born out of lack of monetary control whose results undermined the rules of business, creating havoc in markets and financial ruin of even the prudent."

But Keynes in his General Theory' allayed all such fears. He did not believe like the neo-classicists that there was always full employment in the economy which resulted in hyper-inflation with increases in the quantity of money. According to him, there being underemployment in the economy, an increase in the money supply leads to increase in aggregate demand, output and employment.

Starting from a depression, as the money supply increases, output at first rises proportionately. But as aggregate demand, output and employment rise further, diminishing returns start and certain bottlenecks appear and prices start rising. This process continues till the full employment level is reached. The rise in the price level during this period is known as bottleneck inflation or "semi-inflation". If the money supply increases beyond the full employment level, output ceases to rise and the prices rise in proportion with the money supply. This is true inflation, according to Keynes.

Keynes's analysis is subjected to two main drawbacks. First, it lays emphasis on demand as the cause of inflation, and neglects the cost side of inflation. Second, it ignores the possibility that a price rise may lead to further increase in aggregate demand which may, in turn, lead to further rise in prices.

However, the types of inflation during the Second World War, in the immediate post-war period, till the middle of the 1950s were on the Keynesian model based on his theory of excess demand. "In the latter 1950s, in the United States, unemployment was higher than it had been in the immediate post-war period, and yet prices still seemed to be rising, at the same time, the war time fears of postwar recession had belatedly been replaced by serious concern about the problem of inflation.

The result was a prolonged debate…On the one side of the debate was the 'cost-push' school of thought, which maintained that there was no excess demand…On the other side was the "demand-pull" school…Later, in the United States, there developed a third school of thought, associated with the name of Charles Schultz, which advanced the sectoral 'demand-shift theory' of inflation… While the debate over cost-push versus demand- pull was raging in the United States, a new and very interesting approach to the problem of inflation and anti-inflationary policy was developed by A. W. Phillips."

We shall study all theories mentioned here, besides Keynes's theory of the inflationary gap. But before we analyses them, it is instructive to know about the meaning of inflation.

Meaning of Inflation:

To the neo-classical and their followers at the University of Chicago, inflation is fundamentally a monetary phenomenon. In the words of Friedman, "Inflation is always and everywhere a monetary phenomenon…and can be produced only by a more rapid increase in the quantity of money than output.'" But economists do not agree that money supply alone is the cause of inflation.

As pointed out by Hicks, “Our present troubles are not of a monetary character.” Economists, therefore, define inflation in terms of a continuous rise in prices. Johnson defines “inflation as a sustained rise”[4] in prices. Brooman defines it as “a continuing increase in the general price level.”[5] Shapiro also defines inflation in a similar vein “as a persistent and appreciable rise in the general level of prices.” Demberg and McDougall are more explicit when they write that “the term usually refers to a continuing rise in prices as measured by an index such as the consumer price index (CPI) or by the implicit price deflator for gross national product.”

However, it is essential to understand that a sustained rise in prices may be of various magnitudes. Accordingly, different names have been given to inflation depending upon the rate of rise in prices.

1. Creeping Inflation:

When the rise in prices is very slow like that of a snail or creeper, it is called creeping inflation. In terms of speed, a sustained rise in prices of annual increase of less than 3 per cent per annum is characterised as creeping inflation. Such an increase in prices is regarded safe and essential for economic growth.

2. Walking or Trotting Inflation:

When prices rise moderately and the annual inflation rate is a single digit. In other words, the rate of rise in prices is in the intermediate range of 3 to 6 per cent per annum or less than 10 per cent. Inflation at this rate is a warning signal for the government to control it before it turns into running inflation.

3. Running Inflation:

When prices rise rapidly like the running of a horse at a rate or speed of 10 to 20 per cent per annum, it is called running inflation. Such an inflation affects the poor and middle classes adversely. Its control requires strong monetary and fiscal measures, otherwise it leads to hyperinflation.

4. Hyperinflation:

When prices rise very fast at double or triple digit rates from more than 20 to 100 per cent per annum or more, it is usually called runaway ox galloping inflation. It is also characterised 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 every day. Such a situation brings a total collapse of monetary system because of the continuous fall in the purchasing power of money.

The speed with which prices tend to rise is illustrated in Figure 1. The curve C shows creeping inflation when within a period of ten years the price level has been shown to have risen by about 30 per cent. The curve W depicts walking inflation when the price level rises by more than 50 per cent during ten years. The curve R illustrates running inflation showing a rise of about 100 per cent in ten years. The steep curve H shows the path of hyperinflation when prices rise by more than 120 per cent in less than one year.

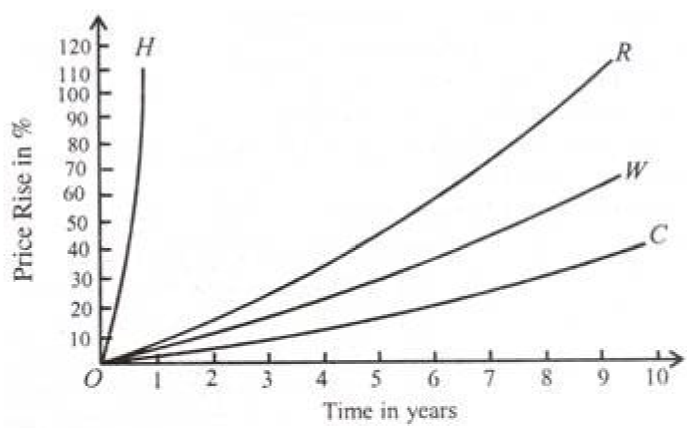

Fig. 1.

Source: Internet

5. Semi-Inflation:

According to Keynes, so long as there are unemployed resources, the general price level will not rise as output increases. But a large increase in aggregate expenditure will face shortages of supplies of some factors which may not be substitutable. This may lead to increase in costs, and prices start rising. This is known as semi-inflation or bottleneck inflation because of the bottlenecks in supplies of some factors.

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.