''बेटी बचाओ, बेटी पढ़ाओ''

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 – Structural Inflation

Introduction:

There is another important theory of inflation known as structural inflation which explains inflation in the developing-countries in a slightly different way. The structuralists argue that increase in investment expenditure and the expansion of money supply to finance it are the only proximate and not the ultimate factors responsible for inflation in the developing countries.

According to them, one should go deeper into the question as to why aggregate output, especially of food-grains, has not been increasing sufficiently in the developing countries to match the increase in demand brought about by the increase in investment expenditure, and money supply. Further, they argue why investment expenditure has not been fully financed by voluntary savings and as a result excessive deficit financing has been done.

Structural theory of inflation has been put forward as an explanation of inflation in the developing countries especially of Latin America. The well-known economists, Myrdal and Straiten who have proposed this theory have analysed inflation in these developing countries in terms of structural features of their economies. Recently Kirkpatrick and Nixon have generalised this structural theory of inflation as an explanation of inflation prevailing in all developing countries.

Myrdal and Streeten have argued that it is not correct to apply the highly aggregative demand- supply model for explaining inflation in the developing countries. According to them, there is a lack of balanced integrated structure in them where substitution possibilities between consumption and production and inter-sectoral flows of resources between different sectors of the economy are not quite smooth and quick so that the inflation in them cannot be reasonably explained in terms of aggregate demand and aggregate supply. In this connection it is noteworthy that Prof. V.N. Pandit of Delhi School of Economics has also felt the need for distinguishing price behaviour in the Indian agricultural sector from that in the manufacturing sector.

Thus, it has been argued by the exponents of structural theory of inflation that economies of the developing countries of Latin America and India are structurally underdeveloped as well as highly fragmented due to the existence of market imperfections and structural rigidies of various types.

The result of these structural imbalances and rigidies is that whereas in some sectors of these developing countries, we find shortages of supply relative to demand, in others under-utilisation of resources and excess capacity exist due to lack of demand.

According to structuralists, these structural features of the developing countries make the aggregate demand-supply model of inflation inapplicable to them. They therefore argue for analysing dis-aggregative and sectoral demand-supply imbalances to explain inflation in the developing countries.

They mention various sectoral constraints or bottlenecks which generate the sectoral imbalances and lead to rise in prices. Therefore, to explain the origin and propagation of inflation in the developing countries, the forces which generate these bottlenecks or imbalances of various types in the process of economic development need to be analysed.

A study of these bottlenecks is therefore essential for explaining inflation in the developing countries.

These bottlenecks are of three types:

(1) Agricultural bottlenecks which make supply of agricultural products inelastic,

(2) Resources constraint or Government budget constraint, and

(3) Foreign exchange bottleneck. Let us explain briefly how these structural bottlenecks cause inflation in the developing countries.

Agricultural Bottlenecks:

The first and foremost bottlenecks faced by the developing countries relate to agriculture and they prevent supply of food grains to increase adequately. Of special mention of the structural factors are disparities in land ownership, defective land tenure system which act as disincentives for raising agricultural production in response to increasing demand for them arising from increase in people's incomes, growth in population and urbanisation.

Besides, use of backward agricultural technology also hampers agricultural growth. Thus, in order to control inflation these bottlenecks have to be removed so that agricultural output grows rapidly to meet the increasing demand for it in the process of economic development.

Resources Gap or Government's Budget Constraint:

Another important bottleneck mentioned by structuralists relate to the lack of resources for financing economic development. In the developing countries planned efforts are being made by the Government to industrialise their economies. This requires large resources to finance public sector investment in various industries. For example, in India, huge amount of resources were used for investment in basic heavy industries started in the public sector.

But socio-economic and political structure of these countries is such that it is not possible for the Government to raise enough resources through taxation, borrowing from the public, surplus generation in the public sector enterprises for investment in the projects of economic development. Revenue raising from taxation has been relatively very small due to low tax base, large scale tax evasion, inefficient and corrupt tax administration.

Consequently, the government has been forced to resort to-excessive deficit financing (that is, creation of new currency) which has caused excessive growth in money supply relative to increase in output year after year and has therefore resulted in inflation in the developing countries.

Though rapid growth of money supply is the proximate cause of inflation, it is not the proper and adequate explanation of inflation in these economies. For proper explanation of inflation one should go deeper and enquire into the operation of structural forces which has caused excessive growth in money supply in these developing economies.

Besides, resources gap in the private sector due to inadequate voluntary savings and under-development of the capital market have led to their larger borrowings from the banking system which has created excessive bank credit for it.

This has greatly contributed to the growth of money supply in the developing countries and has caused rise in prices. Thus, Kirkpatrick and Nixon write, "the increase in the supply of money was a permissive factor which allowed the inflationary spiral to manifest itself and become cumulative—it was a system of the structural rigidities which give rise to the inflationary pressures rather than the cause of inflation itself.

Foreign Exchange Bottleneck:

The other important bottleneck which the developing countries have to encounter is the shortage of foreign exchange for financing needed imports for development. In the developing countries ambitious programme of industrialisation is being undertaken.

Industrialisation requires heavy imports of capital goods, essential raw materials and in some cases, as in India, even foodgrains have been imported. Besides, imports of oil on a large scale are being made. On account of all these imports, import expenditure of the developing countries has been rapidly increasing.

On the other hand, due to lack of export surplus, restrictions imposed by the developing countries, relatively low competitiveness of exports, the growth of exports of the developed countries has been sluggish. As a result of sluggish exports and mounting imports, the developing countries have been facing balance of payment difficulties and shortage of foreign exchange which at times has assumed crisis proportions.

This has affected the price level in two ways. First, due to foreign exchange shortage domestic availability of goods in short-supply could not be increased which led to the rise in their prices. Secondly, in Latin American countries as well as in India and Pakistan, to solve the problem of foreign exchange shortage through encouraging exports and reducing imports devaluation in the national currencies had to be made. But this devaluation caused rise in prices of imported goods and materials which further raised the prices of other goods as well due to cascading effect. This brought about cost-push inflation in their economies.

Physical Infrastructural Bottlenecks:

Further, the structuralists point out various bottlenecks such as lack of infrastructural facilities i.e., lack of power, transport and fuel which stands in the way of adequate growth in output. At present in India, there is acute shortage of these infrastructural inputs which are hampering growth of output. Sluggish growth of output on the one hand, and excessive growth of money supply on the other have caused what is now called stagflation, that is inflation which exists along with stagnation or slow economic growth.

According to the structuralist school of thought, the above bottlenecks and constraints are in the social, political and economic structure of these countries. Therefore, in its view a broad – based strategy of development which aims to bring about social, institutional and structural changes in these economies is needed to bring about economic growth without inflation.

Further, many structuralists argue for giving higher priority to agriculture in the strategy of development if price stability is to be ensured. Thus, we see that structuralist view is greatly relevant for explaining inflation in the developing countries and for the adoption of measures to control it. Let us further elaborate the causes of inflation in the developing countries.

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.