JAYOTI VIDYAPEETH WOMEN'S UNIVERSITY, JAIPUR

"बेटी बचाओ, बेटी पढ़ाओ"

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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 –Types of Inflation -II

Introduction:

6. True Inflation:

According to Keynes, when the economy reaches the level of full employment, any increase in aggregate expenditure will raise the price level in the same proportion. This is because it is not possible to increase the supply of factors of production and hence of output after the level of full employment. This is called true inflation.

The Keynesian semi-inflation and true inflation situations are illustrated in Figure.2.

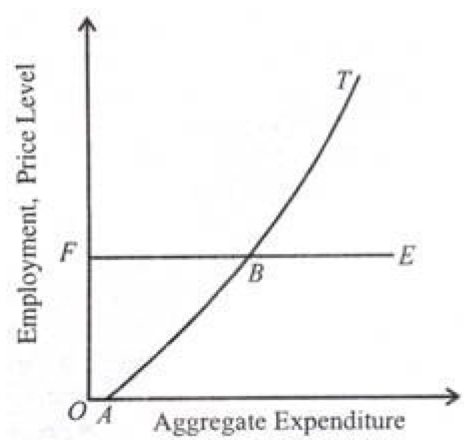

Fig. 2

Source: Internet

Employment and price level are taken on vertical axis and aggregate expenditure on horizontal axis. FE is the full employment curve. When with the increase in aggregate expenditure, the price level rises slowly from A to the full employment level B, this is semi-inflation. But when the aggregate expenditure increases beyond point B the price level rises from B to T in proportion to the increase in aggregate expenditure. This is true inflation.

7. Open Inflation:

Inflation is open when “markets for goods or factors of production are allowed to function freely, setting prices of goods and factors without normal interference by the authorities. Thus open inflation is the result of the uninterrupted operation of the market mechanism. There are no checks or controls on the distribution of commodities by the government. Increase in demand and shortage of supplies persist which tend to lead to open inflation. Unchecked open inflation ultimately leads to hyperinflation.

8. Suppressed Inflation:

Men the government imposes physical and monetary controls to check open inflation, it is known as repressed or suppressed inflation. The market mechanism is not allowed to function normally by the use of licensing, price controls and rationing in order to suppress extensive rise in prices.

So long as such controls exist, the present demand is postponed and there is diversion of demand from controlled to uncontrolled commodities. But as soon as these controls are removed, there is open inflation. Moreover, suppressed inflation adversely affects the economy.

When the distribution of commodities is controlled, the prices of uncontrolled commodities rise very high. Suppressed inflation reduces the incentive to work because people do not get the commodities which they want to have. Controlled distribution of goods also leads to mal-allocation of resources. This results in the diversion of productive resources from essential to non-essential industries. Lastly, suppressed inflation leads to black marketing, corruption, hoarding and profiteering.

9. Stagflation:

Stagflation is a new term which has been added to economic literature in the 1970s. It is a paradoxical phenomenon where the economy expedience’s stagnation as well as inflation. The word stagflation is the combination of‘ stag’ plus ‘flation’ taking ‘stag’ from stagnation and ‘flation’ from inflation.

Stagflation is a situation when recession is accompanied by a high rate of inflation. It is, therefore, also called inflationary recession. The principal cause of this phenomenon has been excessive demand in commodity markets, thereby causing prices to rise, and at the same time the demand for labour is deficient, thereby creating unemployment in the economy.

Three factors have been responsible for the existence of stagflation in the advanced countries since 1972. First, rise in oil prices and other commodity prices along with adverse changes in the terms of trade, second, the steady and substantial growth of the labour force; and third, rigidities in the wage structure due to strong trade unions.

10. Mark-up Inflation:

The concept of mark-up inflation is closely related to the price-push problem. Modem labour organisations possess substantial monopoly power. They, therefore, set prices and wages on the basis of mark-up over costs and relative incomes. Firms possessing monopoly power have control over the prices charged by them. So they have administered prices which increase their profit margin. This sets off an inflationary rise in prices. Similarly, when strong trade unions are successful in raising the wages of workers, this contributes to inflation.

11. Ratchet Inflation:

A ratchet is a toothed wheel provided with a catch that prevents the ratchet wheel from moving backward. The same is the case under ratchet inflation when despite downward pressures in the economy, prices do not fall. In an economy having price, wage and cost inflations, aggregate demand falls below full employment level due to the deficiency of demand in some sectors of the economy.

But wage, cost and price structures are inflexible downward because large business firms and labour organisations possess monopoly power. Consequently, the fall in demand may not lower prices significantly. In such a situation, prices will have an upward ratchet effect, and this is known as “ratchet inflation.”

12. Sectoral Inflation:

Sectoral inflation arises initially out of excess demand in particular industries. But it leads to a general price rise because prices do not fall in the deficient demand sectors.

13. Reflation:

Is a situation when prices are raised deliberately in order to encourage economic activity? When there is depression and prices fall abnormally low, the monetary authority adopts measures to put more money in circulation so that prices rise. This is called reflation.

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.