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CHAPTER—INFLATION- DEFINITION CHARACTERISTICS AND TYPES.

Meaning And Definition Of Inflation

In present day inflation has become a global phenomenon. There is hardly any country in this capitalist world which is not affected by the spectre of inflation. In general speaking, a rapid increase in the general price level is known as inflation .Inflation in the popular meaning is generally associated with rapidly rising prices which cause a decline in the purchasing power of money.

By inflation we mean a general rise in prices. To be more correct, inflation is a persistent rise in the general price level rather than a once-for-all rise in it. On the other hand ,deflation represents persistently failing prices. Inflation or persistently rising price is a major problem in India today .When price level rises due to inflation, the value of money falls .When there is a persistent rise in price level, the people need more and more money to buy goods and service .To enable the people to meet their daily needs of consumption of goods and service when there prices are rising, their incomes must rise if they have to maintain their standard of living. For govt employees, their dearness allowance is increased. Wage and salaries employed in the organised private sector are also raised, though after some time late. But people with fixed incomes and those who are self-employed are un able to raise their prices suffer a lot due to inflation. The poor suffer the most from persistent rise in prices, especially of food grains and other essential items.

According to **CROWTHER,** "Inflation is a state in which the value of money is falling ,i.e. prices are rising."

According to **KEYNES,** "The rise in the price-level after the point of full employment is true inflation."

CHARACTERISTICS OF INFLATION

These are defined on the basis of following circumstances:

1.**When volume of currency is increasing and production is fixed.**

2.When volume of currency is fixed and production is reducing.

3.When volume of currency is decreasing and production is falling but volume of production is decreasing rapidly.

4.When volume of currency and production are increasing but rate of increase of production is less.

5.When volume of production and currency are fixed but volume of currency is more than enough.

EFFECT OF INFLATION

Changes in the value of money affects each individual differently. When prices in general are rising, debtors, businessmen, and corporation stockholders normally enjoy an improvement in their position, while creditors, wages earners and salaried workers, landlords and others who received fixed incomes are adversely affected. The concrete effects of inflation on various groups of society are as follows:

1.EFFECT ON REDISTRIBUTION OF INCOME AND WEALTH:

A. **Effect on consumers:** The effect of inflation on consumers is not good .People as consumers suffer heavily on account of the rising prices. The cost of living does not rise proportionately to income . Under such conditions consumers are called upon to pay higher prices for article of consumption. Thus, inflation gives rise to a sense of futility, desperation and revolt among the consumers.

B. Effect on wage earners and salaried people: Wage and salary earners suffer during inflation period because wages and salaries generally do not rise in the same proportion as the price rises .Therefore ,the purchasing power of wages and salaries diminishes during period of rising prices and the wages and salaries earners end thus hard-hit.

C.Effect on farmers: During the period of inflation farmers are generally the gainers. The prices of agricultural commodities go up while the cost incurred by the farmers do not go up to the same extent. It should, however, be remembered that small farmers do not gain as much as the big farmers do from rising prices, because the farmers do not have a considerable surplus to dispose off in the market.

D. Effect on debtors and creditors: During inflation period , debtors are generally the gainers while the creditors are the losers .Because, the debtors had borrowed the sum when the purchasing power of money was high and now the purchasing of money is low due to rising prices when the loan is returned. In other words , the debtors while repaying their debts return less purchasing power to the creditors than what they had actually borrowed. Thus, the creditors are adversely affected during inflation period and the debtors prove to be the gainers.

E. **Effects on entrepreneurs and businessmen:** The entrepreneurs, manufacturers, wholesalers and retailers gain during period of rising prices. They gain due to three reasons. First, they are mostly debtors and debtors gain when price rise. Secondly, they buy raw materials and other goods at low and lower prices and sell when prices are generally higher. Thirdly, wages and other fixed elements in their costs do not rise as much as the rise in prices. As a result they earn surplus profit and increase their productive activities, consequently offer more employment opportunities to others.

F. Effects on investor: Generally, there are two types of investors. (i) Investors in shares and (ii) investors in debentures and fixed types of loans etc. Former type of investors are gainers and latters are losers during the inflationary period. Dividends on shares increase with the increase in prices, consequently the shareholders are favourably affected on the other hand, income on the debenture etc. remain fixed and the debenture holders are adversely affected.

G. Effect on the fixed –income group: The people belong to fixed-income group are badly affected during inflation period, because their incomes, being fixed, do not bear any relationship with the rising cost of living. Teachers, clerks ,government servants are not able to meet their ends because off rise in prices. They lead a miserable life.
F. Effectors on investors: Generally, there are two types of investors (i) Investors in shares
H. Social and moral effects: During inflation, bribery and black marketing become rampant. Every body tries to earn money by whatever means he can. Further, because of rise in prices all around dissatisfaction is caused amongst consumers ,labourers and middle class people, and as a result there of, they become struggle minded

2. EFFECT ON PRODUCTION;

A.Mis allocation of resources- Inflation causes misallocation of resources when producers divert resources from the production of essential to non-essential goods from which they expect higher profit

B. Change in the system of transaction-They devote more time and attention to converting money in to inventories or other financial or real assets. . It means that time and energy are diverted from the production of goods and services and some resources are used wastefully.

C. Fall in quality- Continuous rise in price create a seller's market .In such a situation producers produce and sell sub-standard commodities in order to earn higher profits.

D. Hoarding and black marketing—To profit more from rising prices, producers hoard stocks of their commodities. Consequently, an artificial scarcity of commodities is created in the market. Then the producers sell their products in the black market which increases inflationary pressures.

E. Reduction in saving—When prices rise rapidly, the propensity to save declines because more money is needed to buy goods and services than before. Reduced saving adversely affects investment and capital formation. As a result, production is hindered.

F. Hinders foreign capital—Inflation hinders the inflow of foreign capital because the rising costs of materials and other inputs make foreign investment less profitable.

G. Encourages speculation—Rapidly rising prices create uncertainty among producers who indulge in speculative activities in order to make quick profits. Instead of engaging themselves in productivity activities, they speculate in various types of raw materials required in production.

3. OTHER EFFECTS:

Inflation leads to a number of other effects which are discussed as under:

A .Government—Inflation affects the government in various ways. It helps the government in financing its activities through inflationary finance. As the money incomes of the people increase, government collects that in the form of taxes on incomes and commodities.So the revenues of the government increase during rising prices .Moreover, the real burden of the public debt decreases when prices are rising. But the government expenses also increase with rising production costs of public projects and enterprises and increase in administrative expenses as prices and wages rise.

B. Balance of payments—Inflation involves the sacrificing of the advantages of international specialisation and division of labour .It affects adversely the balance of payments of a country. When prices rise more rapidly in the home country than in foreign countries, domestic products become costlier compared to foreign products This tends to increase imports and reduce exports, thereby making the balance of payments unfavourable for the country.

C. Exchange Rate.—When prices rise more rapidly in the home country than in foreign countries, it lowers the exchange rate in relation to foreign currencies.

D. Collapse of the Monetary System—If hyperinflation persists and the value of money continues to fall many times in a day, it ultimately leads to the collapse of the monetary system, as happened in Germany after world war I.

E. Social—Inflation is socially harmful. By widening the gulf between the rich and poor, rising prices create discontentment among the masses. Pressed by the rising cost of living, workers resort to strikes which lead to loss in production. Lured by profits, people resort to hoarding, blackmarketing, adultration, manufacture of substandard commodities, speculation, etc. Corruption spreads in every walk of life. All this reduces the efficiency ofthe economics.

F. Political—Rising prices also encourage agitations and protests by political parties opposed to the government. And if they gather momentum and become unhandy they may bring the downfall of the government. Many governments have been sacrificed at the alter of inflation.