Inflation and Its Effect On Economics Development

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Abstract

Inflation is the burning issue for the economic development of the country. It is becoming more important to economists, politicians, and even people also. It is very essential to control because it is directly impacting on the standard of living of the people. This high inflation is disturbing all economies around the world and India is no exception to that. Mainly Indian government is facing the effects of severe inflation in the form of rising food and energy prices. This paper compiles the concept of inflation and how it is being calculated. It explains about major aspects which play important role in calculating inflation in India. Paper discusses the trend and effect of inflation on Indian economy.

Keywords: Inflation, Economic Development, Demand, Supply, Price etc.

Introduction

Inflation is burning issue for the economic development of the country. It is becoming more important to economists, politicians and even people also. It is very essential to control because it is directly impacting on standard of living of the people. The responsibility for government and politicians, economists is to protect/safe guard common man from inflation. According to statistical data the inflation in India is higher specifically in food items. Causes might be demand/supply side, which reduces the purchasing power of people, which impacting on savings of the people also. Government polices like monetary policy and industrial policy should be prepared in such a manner which decreases inflation in India.

Objective of the study

1. To understand about inflation and causes of inflation in India.
2. To explain the method of calculating inflation in India.
3. To discuss the trend and effect of inflation on growth and economic development.

Significance of study

Any developing economy has to bear an impact of inflation during its economic development especially when the process of growth happens to be at rapid pace. Infact the risk of inflation is up to a point, inherent to be at process. The level of investment required to break through the vicious circle of low income – low saving has to be on a large scale and it is not always possible to meet that investment expenditure from taxation and current saving of the community alone. The policies and monetary regulation are implemented by the government to control the inflation, so that the growth and development pace continue. Inflation is affecting and related with common people. Inflation is not only that Indian government through RBI is printing and injecting more money in the economy. But some other real causes of inflation are not much known to the people, so it is imperative to understand inflation and causes which lead financial crisis. Further important to discuss on statistics to explain the trend of inflation which ultimately impact on economic development. The government needs to take steps to control the inflation and maintain the pace of development.

Define Inflation

Simple meaning of inflation, the present value of the currency is going low. Further inflation refers to be continuous rise in general price level which reduces the value of money or purchasing power over a period of time. Statistically speaking, inflation is measured in terms of percentage rise in the price index (i.e. percentage rate per unit time) usually for an annum or six month or one month.

According to the Crowther says, “Inflation is a state of economy in which the value of money is falling. Examples prices are rising.

According to Coulbourn “Inflation is too much of money chasing too few goods.”

According to Silverman Inflation is define as, “inflation is the term given to the expansion of money supply, in excess of the amount justified by the state of the trade resulting in a general rise in prices”.

Inflation is not the rise of prices, but the excess money printing and expansion of the money supply (huge example is Zimbabwe, where the inflation is around in thousand). For example, earlier let say a product can be bought at Rs. 10, but now the same product cost you Rs. 50, an increase of 400%, if you ask any one why this happened, the answer will be simple the cost of production has gone up so the end value. The reason is right, but the perspective is wrong, the price has not gone up but the value of the money has gone down.

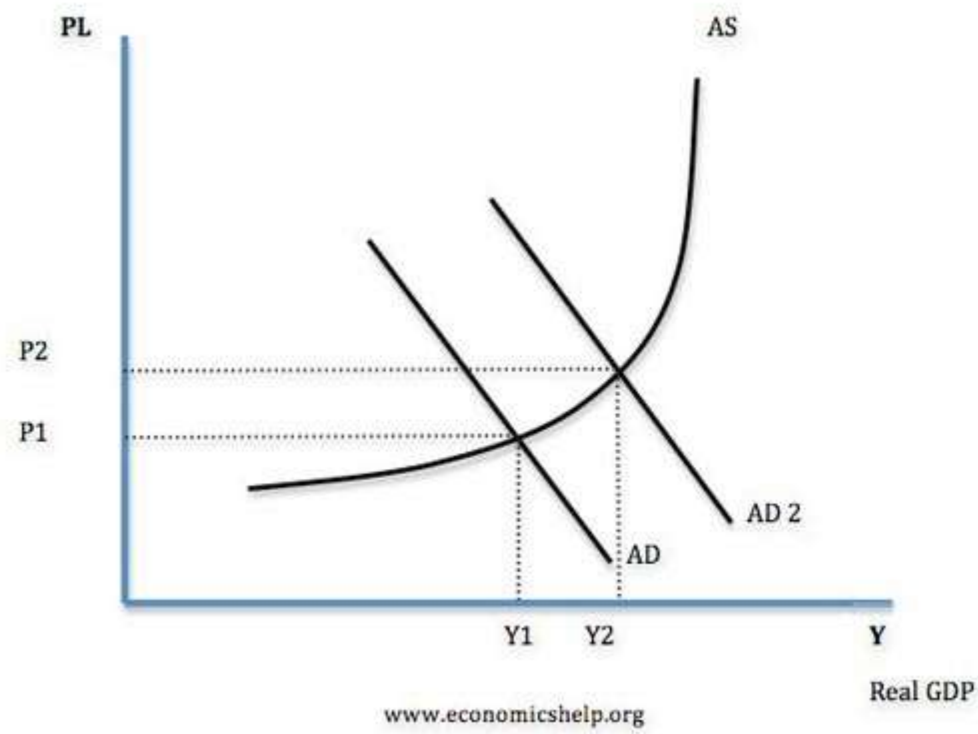
Typeof Inflation

Inflation is of two types majorly:

1. Demand pull inflation.
2. Cost push inflation.

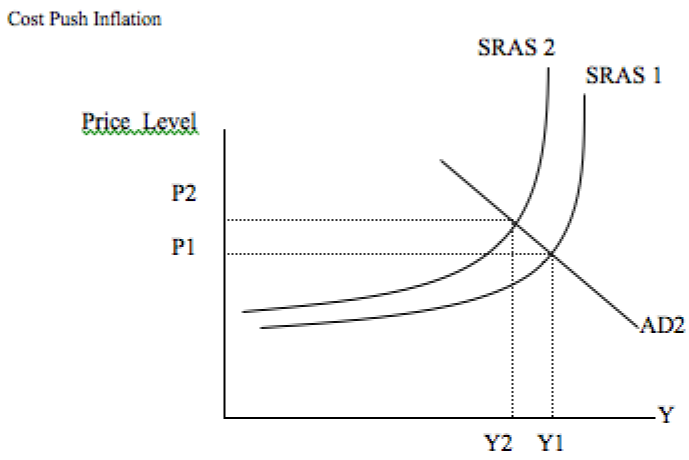
1. Demand pull inflation

Some economists believe that inflation is caused by increase in aggregate demand for goods. They say that demand may rise due to many causes including increased money supply for example; people may reduce savings and spend more. As aggregate demand rises for goods and services, firms try to increase production. To this they need more workers, more machines and more raw materials. If these resources are not available because they are already full employed, the firms will not be able to increase output. In this case, rising demand causes inflation



2. Cost push inflation

Some economists think that inflation occurs due to rising costs. When the firms pass on their increased costs to consumers in the form of higher prices inflation starts. Important sources of rise in cost include workers demand for higher wages, increase in taxes.



The economic survey as termed a new word called skew inflation which was termed after observing inflation which was somewhat unusual, since there was a huge inflation in food sector where the non-food sector was constant. As some sectors was facing a huge inflation and few other sectors faced were no changes or even deflation (opposite to inflation) so they termed it as “skewflation”.

Causeof Inflation

1. Population explosion

Our population is rising at a very fast that is 3%. On other hand the rate of growth of GNP is not very high that is 5.4%. Thus increase in national output is insufficient to solve the problem of scarcity of goods. Since independence, our population has increase four times.

2. Political instability

A country’s economy depends upon political stability. Political instability discourages investment and encourages speculation. Under such circumstances, the industrialist and businessman feel unsecure and cannot make good plans. The government also cannot adopt affective measures to control rise in prices.

3. Imported inflation

A very important cause of inflation in many countries. It exists in countries which depend on other countries for technology and to fulfill their requirements. Since 1970's most countries are experiencing inflation. The result in the Pakistan has to import machinery, raw material and other goods at higher prices.

4. Nationalization

Due to nationalization of industries in 1992, people were discouraged to make investment in industrial. Moreover in many countries the nationalization of industries did not perform well. They become centers of insufficient production, high prices and poor quality goods were result.

5. Wages increases

The increase in wages of workers has also contributed to inflation. Increase in wages result in higher cost of production of goods. So goods price rises.

6. Climatic factors

For those economies which heavily depend upon agriculture but due to weather condition many crops fall short of target, thus pushing up prices. For example cotton production remain stagnant and below target during previous years. Wheat production has also not kept pace with rising demand.

7. Oil crises

The oil prices in 1973 created by a large quantity of inflation throughout the world. Even Iraq crises and many other reasons in recent time lead to rise in crude oil rate. Import of oil is a high burden on our foreign exchange resources. At present 25 percent of our exports are used to pay for oil. From time to time, oil exporting countries increase price of oil, which raises transport cost.

8. Artificial scarcity of goods

Frequent artificial scarcity of essential items is created (cement, ghee, oil, sugar, etc) and huge profits are charged. Similarly through smuggling, large quantity of essential goods is sent to Afghanistan and Pakistan. The mediator creates such environment that they earn maximum profit.

How Inflation Can Be Measured

Changes in the level of prices are determinants to the level of index. The various goods and services and its prices are meant for the index to increase inflation. Inflation is a very tough concept and condition which become serious issue to economists, politicians and for even society people also. Government should mainly concentrate on how to decrease inflation, because inflation mainly impacting on common man in the country. Inflation is a movement where prices of products increase, which decreases the purchasing capacity of the people. When purchasing capacity decrease, the standard of living of the people would decrease. Inflation can be measured basically by using five different measures, in India the Wholesale price Index (WPI) is commonly used method for measuring inflation. The remaining four are belongs to Consumer Price Index (CPI) which contains i. Industrial Workers (IW), ii. Agricultural Labour (AL), iii. Rural Labour (RL) iv. Urban Non-Manual Employees (UNME).In India basically we will use a unique measure to measure the inflation which is Whole sale Price Index (WPI) which takes the data of 435 commodities with different weights which indicate the movement of prices of commodities used in all trade and transactions. The reason for going to measure inflation in India is the data regarding commodities to measure the inflation, whole sale prices are easily available from market.

The year on year the inflation is increasing in India it is around 9% in the year of 2011, where as food inflation was 9.5% at present prices plotted on year on year percentage changes in Whole sale price index for all commodities (WPI). The data depicts that inflation is more than 5% from 2004-2005 to 2007-2008, it will tells us that inflation is in consistent rate around 5%, GDP also fluctuates between 14% to 16% between 2004-2005 and 2007-2008. There is a growth of economy even in inflation between 2004-2005 and 2007-2008. This can be treated as growth-Inflation by So Called economists in the country. There are certain reasons to decrease GDP from 2007-2008 to 2009-2010, where inflation increases from 2007-2008 to 2009-2010. To understand this abnormality all commodities (AC) are classified in to subcategories into: primary articles (PA) consisting of food articles (FA) and Non-food Articles (NF) fuel, power, light and lubricants and manufacturing products (MP). By plotting the values of each category will come to know which product and its price abnormally varied from actual trend. This explains about what are the reasons to decrease GDP and the list of products and its value is differing from actual trend. This is how inflation calculated and depends on prices of various commodities.

Effectson Economic Growth and Development

When the gap between demand and supply widened, consumers are forced to change their purchasing habits. This can result in manufacturers cutting down production, further adding pressure to the supply side and pushing up the prices, thus creating a vicious cycle. Other ways is which high inflation in an economy affects the people.

1. Investment

If the prices of goods increases and people have to compensate for the increase in price, they usually make use of their savings. In the event when savings are depleted, fund for investment is no longer available. An individual tends to invest, only if savings of an individual is strong and has sufficient money to meet his daily needs. Real tax collections do not keep up with inflation, because collections are based on nominal incomes of an earlier year (the Tanzi effect) and public utility prices are not raised in line with inflation. For both reasons, the fiscal problem is intensified by inflation, and public savings may be reduced. This may adversely affect public investment. High inflation is unstable. There is uncertainty about future rates of inflation, which reduces the efficiency of investment and discourages potential investors.

2. Interest rates

Whenever inflation reigns supreme, it is a well known fact that the value of money goes down. This leads to decline in the purchasing power. In the event, when the rate of inflation is high, the interest rates also rise. With increase in both parameters, cost of goods will not remain the same and consequently people will have to shell out more money for the same goods.

3. Exchange rates

Inflation and economic growth are affected by exchange rates as well. Exchange rates denote the value of money prevailing in different countries. High rate of inflation causes severe fluctuations in exchange rates. This adversely affects trade (export and import), important business transaction across borders and value of money also changes.

4. Unemployment

Growth of a nation depends to a large extent on employment. If rate of inflation is high, unemployment rate is low and vice versa. This theory is propounded by economist William Philips and this gave rise to the Philips Curve.

5. Stocks

The returns a company offer, on investment fully depend on the performance of the company. Past performance, current positions of the company and future trends decide how much (money, in form of bonus or dividend) is to be returned to the investors. Owing to inflation, several monetary as well as fiscal policies are impacted.

Conclusion

Finally I want to conclude that high inflation plays major role, to weaken the economy. Mainly high inflation can be seen in food articles, which impact on weaker sections of the people in the nation. Government and policy makers of the economy should think more about, how to reduce inflation. Food is universal need for people. If inflation more in food articles, it will harm to the country people. Inflation should not be there in food articles because food is essential need for all categories of the people. In Percapita income of the people is less, less percapita income of the people surviving is very difficult with high inflation in the country.

Any developing economy has to bear an impact of inflation during its economic development especially when the process of growth happens to be rapid pace. The some bearable inflation require for economic development whereas high inflation affects adversely. To promote growth and keep inflation low, the government needs to control budget deficits. While simulations indicate that this can be achieved by switching public expenditure from consumption to investment, this may be a difficult policy to pursue, especially in a developing country with a multiparty democracy. It may be more realistic to choose tolerable levels of inflation rate and achieve the maximum possible growth with that rate, by deficit-financed public investment.

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