

# INFLATION

Collective increase in the supply of money, in money incomes, or in prices refers to inflation. Inflation is generally thought of as an undue rise in the general level of prices.

## **Definition:**

“Inflation is a situation whereby there is a continuous and persistent rise in the general price level.”

## **According to Meyer:**

“An increase in the prices that occurs after full employment has been attained.”

## **According to Ackley:**

“A persistent and appreciable rise in the general level or average of prices.”

## **According to Crowther:**

“In the state of inflation the prices are rising i. e., the value of money is falling.”

## **According to Coulbourn:**

“In inflation, too much money chases too few goods.”

## **TYPES OF INFLATION:**

Following are the main types of inflation, which are different from one another due to their causes:

- i. **Demand Pull Inflation**  
This is demand side inflation. It simply means that when there is an increase in aggregate demand. Without any corresponding increase in aggregate supply the price level will rise.
- ii. **Cost Push Inflation**  
It is supply side inflation. If there is increase in prices it will result in fall in aggregate supply. It is the reason of increase in cost of production.
- iii. **Structural Inflation**  
Sometimes prices rise in an expanding economy because the supply cannot keep up with rising demand because of structural inflexibilities. This is also called the Structuralist Argument for inflation.
- iv. **Imported Inflation**  
In such inflation local governments are helpless; it is due to an increase in the prices of imported goods. To control it government may ban the imported items.
- v. **Open Inflation**  
If there is no control over rise in prices, it will be determined by free forces of demand and supply.
- vi. **Suppressed Inflation**  
If prices are subject to governmental control then their increase is made by the government action.

vii. **Ex-ante & Ex-post Inflation**

Ex-ante inflation is the expected inflation and ex-post is the actual inflation. For example, if people of Pakistan expect an inflation rate of 10% it will be Ex-ante inflation but actual inflation is 7 % it will be ex-post.

viii. **Ceiling Inflation**

Inflation that occurs due to various prices ceiling enforced by government. Price ceiling are set by government to maintain prices of certain essential goods at a determined level.

ix. **Income Inflation**

If there is an increase in income of the people, it will increase the money supply in the country that leads to income inflation.

## **DEGREES OF INFLATION:**

Inflation contains the following degrees:

i. **Moderate Inflation**

When the rate of inflation is very low, say in the range of 1% to 20%, it is moderate inflation.

- If its rate is less than 5 %, then it is creeping inflation.
- If its rate is more than 5 %, then it is called trotting inflation.

ii. **Galloping Inflation**

When the rate of inflation exceeds 20 % it is called galloping inflation. The upper limit of galloping inflation may roughly be defined as 1000 %.

iii. **Hyper Inflation**

If the rate of inflation is above 1000 %, it can be termed as hyper-inflation.

## **CAUSES OF INFLATION IN PAKISTAN**

Causes of inflation are of two types:

### **A. INCREASE IN DEMAND:**

i. **Increase in Money Supply**

The major cause of increase in the price level is an increase in money supply. It may be due to increase in currency or credit money. Increase in the stock of money induces people to demand more and more of goods and services.

ii. **Increase in Velocity of Money**

According to the Fisher's Quantity Theory of Money, if there is an increase in the velocity of circulation of money it also leads to inflation.

iii. **More Investment**

Investments also play an important role in producing inflation. At the moment of investment the economy's stock of wealth and money expands and it result is in inflation.

- iv. **Non-productive Expenditures**  
Government of Pakistan has to make a lot of non-productive expenditures like defence etc. Such unproductive expenditures lead to the wastage of economy's precious resources and also lead to inflation.
- v. **Corruption & Black Money**  
Corruption and black money leads to increase in aggregate demand, which is cause of inflation. These evils increase aggregate demand and import volume.
- vi. **Deficit Financing**  
Deficit financing is another cause of inflation. It increases the money supply and leads to inflation.
- vii. **Foreign Remittances**  
Increase in foreign remittances is increasing the money supply in our country. Increase in money supply leads to inflation.
- viii. **Foreign Aids**  
Foreign aids are also a source of mobilization of resources form rich countries to poor countries. It is also a cause of inflation in Pakistan.
- ix. **Consumption Trends**  
Due to demonstration effect people of our country want to copy the styles of people of rich countries. In this way there is an increase in consumption trends that leads to inflation.
- x. **Population Bomb**  
Population of Pakistan is increasing day by day. Increasing population is demanding more and it creates inflation.

## **B. DECREASE IN SUPPLY:**

- i. **Slow Agricultural Development**  
Low growth rate of agricultural sector caused in shortage of productivity. It results in low supply and increase in price level.
- ii. **Slow Industrial Growth**  
Our industrial sector is not at developed form due to use of backward techniques of production. Its less production also creates shortage in market and caused in inflation.
- iii. **Increase in Wages & Salaries**  
Now labour is demanding more wages and salaries. Increase in wages and salaries leads to increase in cost that increases the prices. On the other hand due to more wages and salaries there is an increase in income and it caused in inflation.

iv. **Increase in Prices of Imports**

Increase in the prices of imports also leads to creation of inflation. If there is an increase in the prices of oil and other imported raw material then it will cause to reduction in supply.

v. **Devaluation**

The value of our currency is decreased due to devaluation. It makes imported goods more expensive and it leads to shortage of supply.

vi. **Indirect Taxes**

The imposition of indirect taxes is a reason for increase in prices. Sometimes government imposes taxes on some particular commodities. In this case producer may start to decline the production of those goods.

## MEASURES TO CONTROL THE INFLATION

Following measures are suggested to control high inflation:

- Increase in the growth rate of output.
- Government should control the supply of money through effective monetary policy.
- Highly increasing unproductive expenditures must be control.
- Government should check the corruption first to eliminate the inflation.
- Control on population is also necessary to control inflation.
- Reduction in budget surplus.
- Reduction in monetary expansion.
- Effective tax system will be helpful to control the inflation.
- Improvement in balance of payment.
- Developments of agricultural and industrial sector will helps to control the inflation.

## EFFECTS OF INFLATION

Following are **GOOD EFFECTS** of inflation, if rate is 2% to 4%:

- There is increase in production due to inflation.
- Inflation increases the employment opportunities in the country.
- Inflation enhances the process of economic development.
- There is more investment in country at the time of inflation.
- Inflation increases the economic activities that may cause to inventions and innovations.
- Profit of the producers also increases when there is normal inflation.

Following are the **BAD EFFECTS** of inflation:

- It is a huge problem for employees, taking fixed salaries.
- It generates unfair distribution of income and wealth.
- Inflation reduces the saving of the population.
- It is a cause of unfavorable balance of trade and payment.
- Inflation increases the rate of interest.
- It creates a lot of social evils.