

## CAUSES OF INFLATION

The main causes of the process of inflation in a country are as follows:

- (i) Increase in money supply: As the central bank of country increases the supply of money, the money income of the people increases. That leads to an increase in the demand for goods and services, while the supply thereof fail to increase in the same proportion. Thus it brings about an increase in the level of prices.
- (ii) Expansion in credit If the commercial banks follow a liberal credit policy, the business firms can have easy access to credit. The increase in credit flow leads to increased demand for raw materials and capital stock. It pushes up the prices of different categories of products.
- (iii) Increase in the velocity of money:  
Sometimes the monetary authority does not enlarge the supply of money and credit. But for different reason the velocity of circulation of money gets increased. In such

a situation, there is an increase in the demand for consumer and producer goods. It again leads to a rapid increase in prices.

(iv) Deficit financing when the revenue receipts of the government fall short of the public outlay, the government resorts to deficit financing through expansion in currency or borrowing from the central bank and commercial banks. In either of the cases, there is a net increase in the supply of money. As a consequence, the level of prices starts rising.

(v) Increase in consumption: If there is an increase in the demand for consumer goods due to a rise in disposable income and other factors but the supply of these products can not be extended, the upward price movement takes place.

(vi) Increase in investment: If there is an increase in investment spending but the output can be enlarged within a short period due to technical factors, the price

level again has a tendency to move in the upward direction.

(vii) Increase in govt. expenditure : If there is a large increase in government expenditure on defence, administration, internal security, social security and government consumption, the demand for goods and services increases, while their supply can not be increased. In such a situation, the price starts rising sharply.

(viii) Existence of black money : when there is the existence of a large amount of black money or the unaccounted money, the price have a strong tendency to rise. The black money is often used for such activities as hoarding, black marketing and smuggling of goods, speculation, real estate transactions etc. Such uses of black money invariably create shortage of goods and the consequent rise in prices.

(ix) Increase in population : The increase in population results in shortages of essential consumer goods like food grains and other food product, cloth, shoes and several other product and services. Thus increasing popu-

lation creates strong and sustained inflationary pressures in the economy.

(X) Shortage of foodgrains: If the agriculture production is hit adversely by the unfavourable weather conditions, floods, drought etc, shortage of foodgrains appear. People have to meet their food needs, even if they have to pay very high prices. Thus food shortage leads to serious inflationary condition.

(XI) Shortage of raw material, fuel, power etc. If a country faced with shortage of raw material, fuel like oil, power, coal etc. The cost of production of industrial manufactured products increase. It leads to the rise in prices of the products in the country.

(XII) Increase in wages: If there is an increase in wage rates, the cost of production increases. It causes a rise in the prices of the products.

(XIII) Emphasis on heavy industries: If a country plans to undertake investment on a large scale upon the heavy and capital goods industries which have a long gestation period, the production fails to increase while investment expenditure continues to rise, the economy experiences sharp increase in price level.

(XIV) Industrial dispute: The existence of industrial disputes between labour and management leads to strikes and lock outs in various industries. As production gets disrupted, the shortage of goods appear. It causes an increase in the level of prices.

(XV) Hoarding and Profiteering: If some unscrupulous businessmen indulge in illegal activities like hoarding, black marketing and profiteering, artificial shortage of essential commodities appear. As a consequence, the economy experiences serious inflationary pressures.

(XVI) Tax policy of the government: If the government of a country excessively takes resort to indirect taxes such as excise duty, sales tax, electricity duty, import duties, the prices tend to increase. Thus tax policy can intensify the inflationary conditions.

(XVII) Trade policy: If the government adopts the policies to promote exports and restrict imports of commodities, the shortages appear in the home country and prices have a strong tendency to increase.