IMPACT OF INFLATION

The various impact of inflation are discussed below :-

A. Impact on Production According to Keynes, moderate or creeping inflation has favourable effect on production particularly when there are unemployed resources in the country. Rising prices increase the profit expectations of the entrepreneurs because the prices increase more rapidly than the cost of production. They are induced to step up investment, and as a result, output and employment increase. Hyper or galloping inflation, on the other hand, creates the uncertainty which is harmful to production. Thus, while mild inflation is favourable to production and employment particularly before full employment, hyper inflation is generally harmful for the economy.

The adverse effect of inflation on production are stated below :-

1. Disrupts price system :- Inflation disrupts the smooth working of the price mechanism, creates rigidities and result in wrong allocation of resources.

2. Reduce saving - Inflation adversely affect saving and capital accumulation. When prices increase, the purchasing power of money falls which means more money is required to buy ~~the~~ same quantity of goods. This reduces saving.

3. Discourage Foreign Capital - Inflation not only reduces domestic saving, it also discourages the inflow of foreign capital into the country. If the value of money falls considerably, it may even drive out the foreign capital invested in the country.

4. Encourage Hoarding: When prices increase, hoarding of larger stocks of goods become profitable. As a consequence of hoarding, available supply of goods in relation to increasing monetary demand decreases. This result in black marketing and causes further price - spiral.

5. Encourage Speculation Activities :- Inflation ~~prom~~ promotes speculative activities on account of uncertainty created by a continually rising prices. Instead of earning profits through genuine productive activity, the businessmen find it easier to make quick profits through speculative activities.

6. Reduce of volume of Production: Inflation reduces the volume of production because accumulation has slowed down and business uncertainty discourage entrepreneurs from taking business risk in production.

7. Affects pattern of production - Inflation adversely affect the pattern of production by diverting the resources from the production of essential goods to that of non-essential goods or luxuries because the rich, whose incomes increase more rapidly demand luxury goods.

8. Quality falls: Inflation create a sellers market in which sellers have command on

prices because of excessive demand. In such a market, any thing can be sold. Since the producer's interest is only higher profits, They will not care for the quality.

(B) Impact on Distribution

Inflation results in redistribution of income and wealth because the prices of all the factors of production do not increase in the same proportion. Generally, the flexible income groups, such as businessmen, traders, merchants, speculators gain during inflation due to wind-fall profits that arise because prices rise faster than the cost of production. On the other hand, the fixed income groups, such as workers, Salaried persons, teachers, pensioners, interest and rent earners, are always the losers during inflation because their incomes do not increase as fast as the prices. Inflation is unjust because it puts economic burden on those sections of the Soceity who are least able to bear it.

The effects of inflation on different groups of society are as follows:-

(1) Debtors and Creditors:- During inflation,

the debtors are the gainers and the creditors are the losers. The debtors stand to gain because they had borrowed when the purchasing power of money was high and now return the loans when the purchasing power of money is low due to inflation. The creditors, on the other hand, stand to lose because they get back less in terms of goods and services than what they had lent.

(2) Wage and Salary Earners:- Wage and Salary earners usually suffer during inflation because wages and salaries do not rise in the same proportion in which the prices or the cost of living rises and there is a lag between a rise in the price level and a rise in wage and salary. Among workers, those who have formed trade unions, stand to lose less than those who are unorganised.

(3) Fixed Income Groups: The fixed-income groups are the worst suffers during inflation. Person who live on past saving, Pensioners,

interest and rent earners suffer during periods of rising prices because their incomes remain fixed.

(4) Business Community :- The business community, i.e. the producers, traders, entrepreneurs, speculators, etc. stand to gain during inflation
(a) They earn wind-fall profits because price rise at a faster rate than the cost of production
(b) They gain because the prices of their inventories go up, thus increasing their profits.
(c) They also gain because they are normally borrowers of money for business purposes.

(5) Investors The effect of inflation on investors depends on in which asset the money is invested. If the investors invest their money in equities, they are gainers because of the rise in profit. If the investors invest their money in debentures and fixed income bearing securities bonds, etc, they are the loser because income remains fixed.

(6) Farmers Farmers generally gain during inflation because the prices of the farm

products increase faster than the cost of production, thus leading to higher profits during inflation.

Thus inflation redistributes income and wealth in such a way as to harm the interests of the consumers, creditors, small investors, labourers, middle class and fixed income groups and to favour the businessmen, traders, debtors, farmers etc. Inflation is soceity unjust because it makes the rich richer and the poor poorer, it transfers wealth from those who have less of it to those who have already too much of it.

(C) Non-Economic Consequences

Inflation has far reaching social, moral and political consequences.

1. Social Effects: Inflation is socially unjust and unequitable because it leads to redistribution of income and wealth in favour of the rich. This widens the gap between haves and have-nots and creates conflict and tension in the society.

(2) Moral Effects :- Inflation adversely affects business morality and ethics. It encourage black marketing and enable the businessmen to reap wind-fall gains by undesirable means. In order to increase the profit margin, the producers reduce the quality by introduction of adulteration in their products.

(3) Political Effects: Inflation also disrupts the political life of a country. It corrupt the politicians and weakens the political discipline. Again, social inequality and moral degradation resulting from inflationary pressures lead to general discontentment in the public which may result in the loss of faith in the government. Generally dissatisfaction among masses may sometimes result in political revolution ~~or toppling~~ of the government. It was the hyperinflation in Germany during 1920s that made Hitler a dictator.

In short, inflation is undesirable because of its all round harmful consequences. It should be avoidable if possible, and if it occurs should be checked before it is too late.