CONTROL OF INFLATION

The measures against inflation can be divided into —

(a) Monetary Policy (b) Fiscal Policy
(c) Direct controls (d) Other Measures.

(A) Monetary Policy

Monetary policy is adopted, by the monetary authority or the Central bank of a country to influence the supply of money and credit by changing interest rate structure and availability of credit.

Various monetary measures to control inflation are explained below -

(1) Increasing Bank Rate :- Bank rate is the rate at which the Central bank lends money to the Commercial banks. An increase in the bank rate leads to an increase in the interest rate charged by Commercial banks which in turn, discourage borrowing by businessmen and Consumers. This will reduce money supply with public and this control the inflationary pressure.

(2) Sale of Government Securities By selling government securities in the open market, the

Central bank directly reduces the cash reserve of the commercial banks because the central bank must be paid from these cash reserves. The fall in the cash reserves compels the bank to reduce their lending activities. This will reduce the money supply and hence the inflationary pressure in the economy.

(3) Higher Reserve Ratio Another monetary measure to check inflation is to increase the minimum reserve ratio. An increase in the minimum reserve ratio means that the member banks are required to keep larger reserves with the central bank. This reduces the deposit of the bank and thus limits their power to create credit. Restrictions on credit expansion will control inflation.

(4) Selective Credit Control: The purpose of selective credit control measure is to influence specific type of credit while leaving other types of credit unaffected. Selective credit control measures can direct the flow of credit from unproductive and inflation-prone sectors towards the productive and growth oriented sectors.

The main selective credit control measure to control inflation are :-

(i) Consumer credit Control :- This method is adopted during inflation to curb excessive spending by consumers. In advanced countries most of the durable consumer goods, such as radio, T.V., Fridge etc. are purchased by the consumers on instalment credit. During inflation, loan facilities for instalment buying are reduced to minimum to check consumption spending. This is done by raising the initial payment and reducing the length of the payment.

(ii) Higher Margin Requirement Margin requirement is the difference between the market value of the security and its maximum loan value. A bank does not advance loan equal to the market value of the security, but less. For example, it may lend Rs. 600 against the security worth Rs. 1000; thus the margin requirement in this case is 40%. During inflation, the margin requirement can be raised to reduce the loan one can get on a security.

(B) Fiscal Policy

Fiscal policy is the budgetary policy of the government relating to taxes, public expenditure, public borrowing and deficit financing.

The major anti- inflationary fiscal measures include:-

(1) Increase in taxation (2) Reduction in Public expenditure

(3) increase in Public borrowing

(4) Control of deficit financing.

(1) Increase in taxation:- Anti- inflationary tax policy should be directed towards restricting demand without restricting production. Excise duties and sales tax on various goods, for eg, take away the buying power of the consumer in market without discouraging the expanding productive capacity of the economy. Some economists, therefore, prefer progressive direct taxes because such taxes on the one hand, reduce the disposable income of the people and, on the other hand, are justified

on the basis of social equity.

(2) Reduction in Public Expenditure:- The govt. should reduce unnecessary expenditure on non-development activities in order to curb inflation. This will also put a check on private expenditure which is dependent upon government demand for goods and services. But it is not easy to cut government expenditure as it become difficult to distinguish between essential and non-essential expenditure. Therefore, this measure should be supplemented by taxation.

(3) Public Borrowing:- Through Public borrowing, the government takes away from public excess purchasing power. This will reduce aggregate demand and hence the price level. Ordinarily public borrowing is voluntary left to the free will of individuals. But voluntary public borrowing may not bring to the government sufficient funds to effectively control the inflationary pressures. In such conditions, compulsory public borrowing is necessary. Through compulsory

public borrowing a certain percentage of wages or salaries is compulsorily deducted in exchange for saving bonds which become redeemable after a few years. In this way, purchasing power can be curtailed for a definite period to curb inflation. Compulsory public borrowing has certain limitation as it involves the element of compaulsion on the public and it results in frustration if the government borrows from the poorer section of the public who cannot contribute to this scheme.

(4) Control of Deficit financing :- Deficit financing means financing the deficit budget (i.e excess of government expenditure over it's revenue) through printing of new currency. In order to control inflation, the government should minimise deficit financing. The important thing is that, as far as possible, the deficit should be financed through saving or taxation. The government can sell bonds to non-bank investors like insurance companies, saving bank etc. which will take away the spending power from the public and thus curb inflation.

(c) Direct Controls :-

Direct Controls refer to the regulatory measures undertaken with an objectives of converting an inflation into a suppressed one.

Direct control on prices and rationing of scarce goods are the two such regulatory measures.

1. Direct controls on Prices:- The purpose of price control is to fix an upper limit beyond which the price of particular commodity is not allowed and to that extent inflation is suppressed.

2. Rationing: When the government fixes the quota of certain goods so that each person gets only a limited quantity of the goods, it is called rationing. Rationing becomes necessary when the essential consumer goods are relatively scarce. The purpose of rationing is to divert consumption from those goods whose supply needs to be restricted for some special reason. e.g,

to make such commodities available to a large number of people.

(D) Other measures:

Beside monetary, fiscal and direct measures, there are some other measures which can be taken to control inflation:-

(1) Expansion of output:- Inflation arises partly due to inadequacy of output. But, it is difficult to increase output during inflationary period because the productive resources have already been fully utilised. Under such condition when output as a whole cannot be increased, steps should be taken to increase output of those goods which are sensitive goods (i.e luxury goods) to the production of more inflation - sensitive goods (i.e food, clothing and other essential consumer goods). Such reallocation of resources will keep the prices of essential consumer goods under check by raising their output.

(2) Proper wage policy:- In order to check inflation, it is necessary to control wages and profits and to adopt appropriate wage and income policy. Ceiling on wages and profits

keep down disposable income and check the cost push inflation. wage increase should be allowed to the workers only if their productivity increases; in this way, higher wages will not lead to higher costs and hence higher prices.

(3) Encouragement to Saving:- Increase in private savings has disinflationary impact on the economy. Private savings lead to the reduction of spendable income of the people, which in turn, curtail inflationary pressures. The government should therefore take steps to encourage private saving.

(4) Overvaluation:- Overvaluation of domestic currency in terms of foreign currencies also serves to control inflation in three ways:-

(a) It will discourage exports and thus increase the availabity of goods and services in the domestic market.

(b) It will encourage imports from abroad and thus add to the domestic stock of goods and services.

(c) by reducing the prices of foreign materials which are needed in domestic production, it will control the upward cost-price spiral.

5. Population Control :- In an overpopulated country, like India, the measure to check the growth of population also produce anti-inflationary effects. Effective family planning programmes ultimately reduce the increasing pressures on general demand for goods and services, thus helping to keep the rising prices under control.

6. The above discussion leads to the conclusion that a proper anti-inflationary policy should be comprehensive. It should involve all types of measures and should not exclusively depend upon only on one measure or the other. The problem of inflation must be attacked from all sides with determined efforts.