Q. What are measures to control of Inflation?
Or Explain the anti-inflationary policy.

Ans> It is suggests that three lines of action to check and control an inflationary boom, namely (i) Monetary measures (ii) fiscal Measures and (iii) Other measures. We shall discuss one by one as follows:

(I) Monetary measures: The measures to control this type of inflation must, therefore, be directed towards a reduction in aggregate spending by the community. These can be divided discuss as below:

(i) Increased Re-discount Rates: To curb inflation, the central bank generally increase the re-discount rates. An increase in bank rates tends to discourage borrowings by business and consumers from banks resulting in a fall in the intensity of inflationary pressures in the economy.

(ii) Sales of Government Securities in the Open Market: Another method to check the inflationary boom is to resort to sales of government Securities to the public by the central bank. As the buying public purchases and pays for these government securities the commercial banks reserves with the central bank are correspondingly reduced and they are obliged to adopt a restrictionist credit policy in relation to business requirements.

(iii) Higher Reserve Requirements: An increase in reserve requirements of the member banks also serves as anti-inflationary weapon during inflation. It absorbs the excess reserves of the banking system and thus prevents for further credit expansion.

(iv) Consumer credit Control: This is a device which is generally introduced during inflation to curb excessive spending on the part of consumers. This is done (a) by raising the minimum initial payment on specified goods, (b) by extending the application of consumer credit control (c) by decreasing the length of payment period.

(v) Higher Margin Requirements: Like the consumer credit control, this is also a method of selective credit control. The central bank in its pursuance of an anti-inflationary policy may raise the margin requirements to higher levels.

Scanned with CamScanner

Fiscal Measures: Fiscal policy is now recognized as an important instrument to tackle an inflationary situation. The major anti-inflationary fiscal measures are the following:

(i) Government Expenditure: During inflation government should reduce its own expenditure to the minimum extent possible to help limit the aggregate demand. This policy is absoultely essential to curb inflationary boom.

(ii) Taxation: In order to control inflation the government is required to increase the rates of existing taxes, widen the coverage of taxes and impose fresh taxes. The best anti-inflation tax is personal income tax is personal income tax with steep rates and high surcharges. This would reduce the spendable income in the hands of the public, and thus help to curb inflationary pressure.

(iii) Public borrowing: Public borrowing is another anti-inflationary pressures in the economy. The object of public borrowing is to take away from the public excess purchsing power which, if left free and upward pressure on the price level in view of the limited supplies of goods and services in the economy.

(iii) Debt Management: The existing public debt should be managed in such a manner as to reduce the existing money supply and prevent further credit expansion. Anti-inflationary debt management usually requires repayment of bank-held ~~by commercial~~ debt out of a budgetary surplus.

(iv) Overvaluation: An overvaluation of domestic currency in terms of foreign currencies will also serve as an anti-inflationary in the economy.

(v) Savings: The measure to increase voluntary or compulsory savings make a significant contribution to the anti-inflationary policy.

3. Other Measures: Among the other anti-inflationary measures may be included such as:

(i) Expansion of output: Increased production is the best anti-dote to inflation because

the inflationary gap arises partly due to the inadequacy of output.

(ii) Wage Policy: During an inflationary boom, wage cannot be left free to chase price upward. They have to controlled so as to contain inflationary pressures in the economy.

(c) Price-control and Rationing: Price-control of essential consumer goods was resorted to on a fairly wide scale in various countries of the world to fight inflation during and after the Second World.

In this way, the government can control the inflationary pressure in the economy.

—x—

Q. Explain the difference between demand pull and cost inflation.

Ans: Broadly speaking, there are two main causes of inflation - demand pull and cost-push inflation. There are some difference between demand pull and cost-push inflation. They are as follows:

(1) Demand inflation is caused by an increase in the aggregate effective demand for goods and services in the economy. It is the direct result of an excess of aggregate effective demand over the aggregate supply of goods and services.

On the other hand cost-push inflation is not due to excessive aggregate demand but is caused by an increase in production cost. Cost inflation is generally caused by three factors: (a) increase in wages, (b) increase in the profit margins, (c) heavy commodity taxes.

(2) Demand inflation are related to monetary and fiscal measures which lead to a higher level of unemployment.

On the other hand, cost-push inflation aim at controlling inflation without unemployment

through administrative controls on price increases and income policy.

(3) Of the two types of inflations, cost-push is much more difficult to control than demand inflation. Demand inflation can be tackled by adopting various types of monetary and fiscal measures, but cost-push inflation cannot be easily controlled through monetary and fiscal measures.

(4) Distinction between the two lies the casual sequences involved. cost-push inflation results from increases in factor prices that causes in the final goods ~~and~~ ~~Services~~ Prices. On the other hand, Demand-pull inflation involves a reverse order of causation. It is the increase in the demand for final goods that causes increase in their prices.

(5) Demand-pull inflation can be caused by increased the level of disposable income. On the other hand, cost-push inflation is generally caused by monopolistic groups of the society.

(6) In the demand-pull inflation, the factors which operate on the demand side while in the cost-push inflation, the factors operates on the supply side.

The controversy between demand-pull and cost-push has not yet been settled.) It should however be understood that the crux of the entire matter is that the price movements are the consequences of complex interactions of cost and demand adjustments which are extremely difficult to identify.

=x=

Q. Explain the 'Inflationary Gap'.

Ans> The concept of inflationary gap, upon which Keynes' version of demand inflation rests, has been defined by Kurihara as "the excess of anticipated expenditure over the available output at base prices or at the pre-inflationary prices".

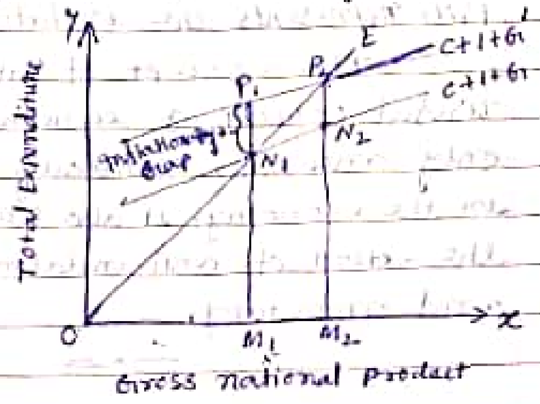
The anticipated total expenditure of the community is determined by the aggregate consumption, investment and governments expenditure. Thus total anticipated expenditure = C+I+G.

Thus, the inflationary gap is the excess of expected expenditure over the available supply of output. The following table summarise the process of inflationary gap.

Demand side		Supply side	
Total money income	300	Gross national product	270
Taxes	50	War expenditure	90
Total disposable income	250	Available output	
Saving	50	for civilian	
Net disposable income	200	Consumption	180

Hence, inflationary gap = 200 − 180 = Rs. 20

The concept of inflationary gap can be illustrated by means of a diagram as shown below:



In the above diagram, the x-axis represents the gross national product and the y-axis shows the total anticipated expenditure. The 45° line OE is the equilibrium line indicating that the economy is equilibrium when the output of goods and services equals the demand for them. The C+I+G curve intersects the line OE at the point N_1. This gives us the equilibrium income indicated by OM_1. Hence, there is no possibility of the emergence of an inflationary gap in the economy in this situation.

Now let us suppose that for some reasons the government increases its expenditure by a certain amount, say P_1N_1 as shown in the above diagram. Thus, the new expenditure function in the economy is C+I+G'. Now P_1N_1 represents the excess of monetary

demand over the available output of goods. Thus, P_1N_1 represents the inflationary gap in the economy.

The concept of inflationary gap is very useful concept of economic analysis. It is not only measures statistically the pressure of inflation in the economy, it also high-lights the nature and the extent of anti-inflationary measures both fiscal and monetary.

=x=

Scanned with CamScanner