INFLATION AND DEFLATION

MEANING OF INFLATION

The literal meaning of the term inflation is ‘spread’ or ‘expansion’ but in reality it is called monetary inflation. Its cause is that it is always a monetary event. In the common language the situation when the price level of goods and services increase and the value of money decrease it is referred to as inflation.

Definition of Inflation

A. Definitions based on Quantity of money- Crowther, Kemmerer, Hawtray, Pigou, golden Wiser etc.

B. Definitions based on demand surplus- Keynes, Turway, Wicksale etc.

TYPES OF INFLATION

(1) Commodity Inflation : It refers to general type of inflation. According to **prof. Keynes,** the prices of commodities rise in a general way in this kind of inflation.

(2) **Currency Inflation :** When a surplus amount of paper money is issued by the central bank of the country to met the requirements of the government and it leads to the rise in prices of goods and services, it is called currency inflation or Deficit-induced Inflation.

(3) **Credit Inflation :** Sometimes the government keeps the amount of money stable and encourages credit. The expansion of credit is done by the banks of the country. When the prices of commodities increase due to expansion of credit, it is called credit inflation.

(4) **Profit Inflation :** Sometimes the cost of production decrease for many reason due to which there is a tendency of decline in prices. But the government takes artificial measures to stop this decline in price. As a result, the production gets additional profit to be profit inflation.

(5) Wage-Induced Inflation: When there is no rise in the production but the producer is compelled to rise wages under the pressure of trade unions, it leads to rise in cost of production. It is called Wage-Induced Inflation.

(6) Production Inflation: When there is no increase in the supply of money, but there is a decline in production due to natural factors like flood, drought, monsoon failure etc. or artificial factors like strike, lockout etc. and there is a rise in the prices of goods, it is called production inflation.

(7) Deficit-Induced Inflation: Sometimes, the government in most democratic countries are incapable of raising funds to meet the increased expenses. In this situation, the government makes a deficit budget. If this deficit is not met even through new taxes, the government issues surplus notes. Consequently, there is a rise in prices which is called Deficit-Induced Inflation.

(8) Full and Partial Inflation: According to Prof. Pigou, when there is an excess increase in the monetary income which crosses to the condition of full employment in the economy, there is rise in prices which is called full inflation. Similarly, before crossing full employment if the quantity of money expands then it is called partial inflation.

(9) Open and Suppressed Inflation: When there is no check on the rising prices in the economy and it is given the freedom of rising independently, it is called Open Inflation. On the contrary, if the government is trying to control it, it is called suppressed or controlled inflation.

(10) Cost-Induced or Cost –Push Inflation: The cost of production increases due to increase in the various sources of production. This leads to the rise of prices of commodities, such inflation is called Cost-Induced or Cost-Push Inflation.

(11) Inflation on the Basis of Speed: On the basis, there are four forms of inflation:

(a) Creeping Inflation: It is also called General Inflation. Such inflation is considered proper for the development of any economy. There is very simple increase in the quantity of money in Creeping Inflation. Generally, an annual increase up to 2 percent is called Creeping Inflation.

(b) Walking Inflation: When the quantity of money in the economy crosses Creeping Inflation i.e. the annual income in the money is more than 2 percent, it is called Walking Inflation. In this inflation, the increase in the prices can be up to 5 percent.

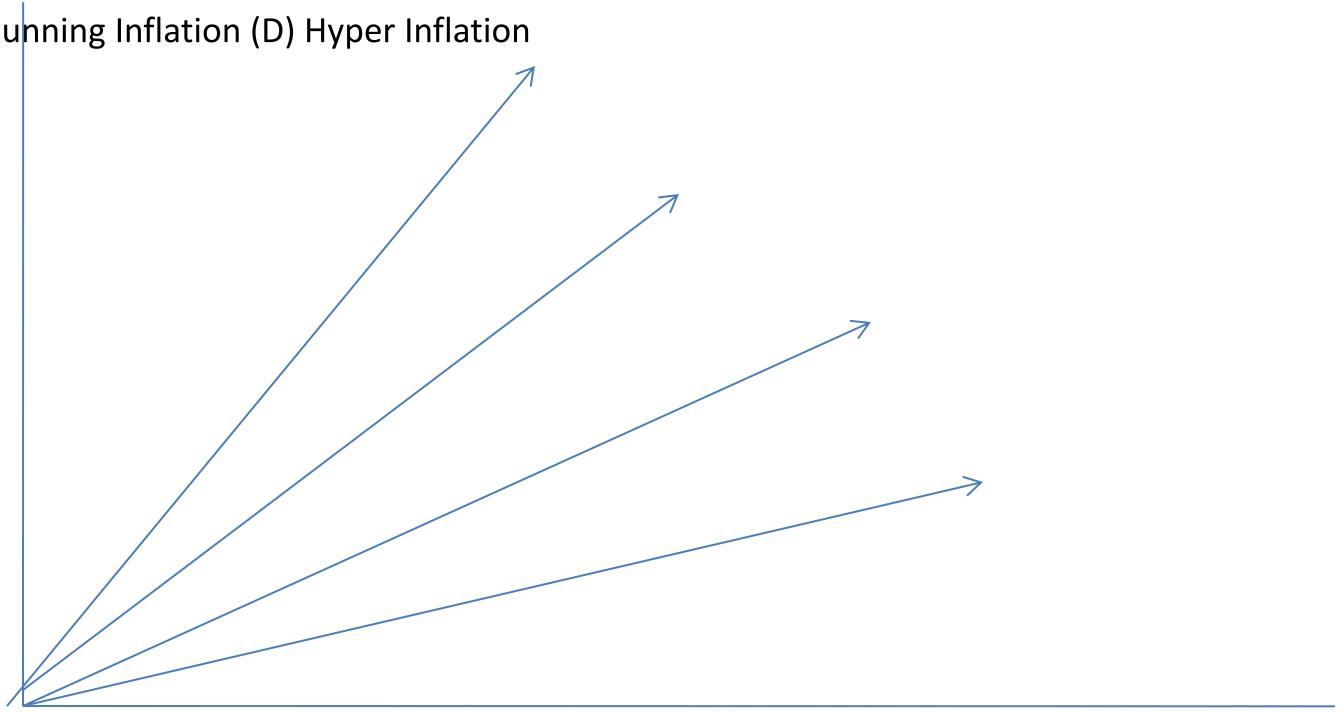
(c) Running Inflation: If the Walking Inflation is not checked and it goes on increasing, it takes the form of Running Inflation. In this inflation, the prices of commodities can increase up to 10 percent. People with stable income face many hardship during this inflation.

(d) Galloping or Hyper Inflation: There is an increase in prices beyond expectation. This increases in price is observed on the daily as well weekly level. Hyper Inflation has a quick adverse impact on the economy.

Clarification through Diagram:

(A) Creeping Inflation (B) Walking Inflation

(C) Running Inflation (D) Hyper Inflation



MEANING OF DEFLATION

Deflation is a situation which is opposite to inflation. Like inflation, it is also an economic sickness. According to **Crowther,** “Deflation becomes a state in which the value of money is rising, i.e. price are falling.” Crowther’s definition is certainly an easy definition but it is a major fault of this definition that in it every fall in the prices related to deflation which is not in reality. Fall in prices after the inflation cannot be called deflation but disinflation.

However, the best definition has been given by Prof. Pigou. According to him, “Deflation is that situation of fall in prices which arises when the production of goods and services increases rapidly as compared to monetary income.

So, it is clear from Prof. Pigou’s definition that every decline in the prices level is not deflation but it arises when the production in the country increases more rapidly as compared to the monetary income of the people.

CAUSES OF DEFLATION

(i) **Reduction in the Quality of money :** When the government reduces the amount of currency in the country, the situation of deflation arises Even if the amount of money is stable end the amount of goods and services increase, the situation of deflation will rise.

(ii) **Increase in Bank rate :** If the central bank increase the bank rate the commercial banks also increase their rates of interest. Consequently, the amount of credit available in the country decrease and the prices began to fall and the situation of deflation emerges.

(iii) **Open Market operations :** When the central bank of the country starts selling the government securities to the common people, it is called open market operation. When these securities are sold, the amount of money in circulation reduces and at the same time there is a decline in deposits with banks.

(iv) **Taxation and public debts :** When government charges higher taxation on people or people take the optional or compulsory loans, the amount of money in circulation in the country reduces and the amount of production stays stable. This brings fall in price;

(v) Increase in Production: When there is an increase in the production of goods and services in the country and there is no increase in the amount of money and credit deflation arises.

(VI) Other Policies of Credit Control: When the Central Bank of the country adopts other dominant steps like rationing of credit, direct action, changes in CRR etc. for the bank rate and open market operation for the credit control, there is deflation of credit money.

EFFECTS OF DEFLATION

(1) **Common People :** The general prices level of goods and services fall during deflation. Consequently, commodities become cheap and common people are benefited.

(2) **Producers and Traders :** Producers and traders face loss during deflation. Its cause is that the cost of production for the producers is high while the selling prices become low. The cause of high cost of production is that raw materials are previously purchased and there is also stock of produced goods having high cost of production.

(3) **Investor :** Those investors who have invested their money in securities like bonds and debentures having stable income benefited. Its cause is hat the purchasing power of their stable income increase.

(4) **Consumers :** Generally, there are two classes of consumers- those with stable income and those with unstable income. Consumers with stable income have profit during the deflation because the purchasing power of their income increase but the consumers with changeable income have loss due to deflation because their income decline more that the decline in the prices of goods.

(5) Labourer Class: The labourers get profit in the initial phase of deflation because there is a fall in prices of goods without any fall in their wages. But gradually the wages are reduced by the producers and there is also reduction in the employment if the industries face bad situations. Thus the labourers face the problem of unemployment. So deflation brings loss for the labourer in the long run.

(6) Banking Sectors: There is a decline in the demand of loans due to recession in the field of trade and industries during deflation. At the same time, there is not proper recovery of previous loans. This hampers the banking activities and there is a bigger possibility of failure of banks with poor economic condition.

(7) Other Effects: Some other effects of deflations are as follows:

(i) The industrial calmness is disrupted during deflation because due to reducing wages and increasing unemployment there is a class between the producers and labourers.

(ii) The export gets encouragement due to the fall in price levels as there is a decline in import.

(iii) Deflation increases the value of money which raises the load of public loans and government and there is a bad effect on the economy.

(iv) The incidence of tax for the tax payers is monetarily less during inflation but they have to pay more tax in form of purchasing power due to high value of money. Thus, tax payers face loss.