

## CHAPTER 2

### MEANING AND CAUSES OF INFLATION

Inflation is considered a global phenomenon. It takes place because of rapidly rising prices of goods and services, resulting in the decline of the value of money.

#### Definitions of Inflation:

According to Prof. Crowther, Inflation is a state in which the value of money is falling and prices are rising. According to Prof. Kemmerer, Inflation means too much currency in comparison to the physical volume of business done. Keynes stated that the rise in the price level after the point of full employment is true Inflation.

#### Causes of Inflation:

The main cause of inflation is the increase in the demand of goods and services and at the same time decrease in the supply of goods and services.

### **Factors causing increase in demand for goods and services:**

Certain factors like increase in public as well as in private expenditure, increase in consumer spending, reduction in taxation, repayment of old internal debts, growth in population, increase in exports and deficit financing cause increase in demand for goods and services.

### **Factors causing a decrease in supply of goods and services:**

Factors like industrial disputes, shortage of factors of production, natural calamities and hoarding of goods cause decrease in supply of goods and services.

## QUESTIONS

### I. Fill in the blanks:

1. Inflation is a \_\_\_\_\_ phenomenon.

(local, national, global)

### II. Answer in one or two sentences:

1. What is the meaning of Inflation in simple terms ?

### III. Answer the following in 5-6 sentences:

1. Explain any five causes responsible for increase in demand ?

## ANSWERS

### I Fill in the blanks:

1. Inflation is a **global** phenomenon.

(local, national, global)

### II. Answer in one or two sentences:

1. What is the meaning of Inflation in simple terms ?

Ans.)

**The meaning of Inflation in simple terms is:**

In simple terms inflation is related to rapidly rising prices of goods, services, causing decline in the value of money which is in inverse proportion to inflation.

### III. Answer the following in 5-6 sentences:

1. Explain any five causes responsible for increase in demand ?

Ans.)

## **Five causes responsible for increase in demand are:**

### **a) Increase in Public Expenditure:**

This leads to increase in the demand for goods and services in the country. This takes place because of the transfer of purchasing power to the household through Public Works Programmes.

### **b) Increase in Consumer Spending:**

When there is an increasing demand for goods and services the Consumer Spending also increases. This happens because of a rise in the money income of the factors of production.

### **c) Reduction in Taxation:**

This is due to the emergence of excess demand in the country. When the government reduces the direct taxes, more disposable income is left in the hands of public.

### **d) Increase in Population:**

The fast increasing population puts a lot of pressure on demands for goods and services in the economy. This increases the price level.

### **e) Increase in Exports:**

With the increase in exports the stock of goods which are available for domestic consumption become less. If more goods are exported to foreign countries there will be less available for home consumption. This leads to shortage in the economy thus giving rise to inflationary pressure.

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