

Meta data of E- Content (Pre production)

S. N.	AREA OF MATA DATA	TO BE FILLED BY CONTENT GENERATOR(S)
1	Topic	Causes of inflation
2	Subject	Indian Economics
3	Topic connected which area of subject?	Current Challenges facing the Indian economy
4	Class/ Level	XI
5	Objectives	To enable the child to: 1. To enable the students to understand the meaning of inflation. 2. To help the students understand the causes behind inflation. : Cost push and demand pull factors.
6	Summary	1. Price of a commodity is determined by the quantity demanded and quantity supplied of the commodity. Price rises when either demand increases or supply decreases. However, a mere rise in the price of a commodity or a few commodities in an economy cannot be termed as inflation. 2. Inflation is a situation of persistent and appreciable rise in the general price level of an economy over a period of time leading to a fall in the purchasing power of money. This implies that every unit of rupee can buy fewer goods and services as an economy witnesses inflation. 3. A mild inflation (less than 3%) is good for an economy as it encourages people to invest in productive areas, thereby boosting an economy
7	Key Words	Inflation, hoarding, black money, black marketing, demand pull inflation, cost push inflation money supply, disposable income, demonstration effect, CRR, SLR, VAT, excise duty, sales tax, wage price spiral, minimum support price.

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Inflation is a situation of persistent and appreciable rise in the general price level of an economy over a period of time leading to a fall in the purchasing power of money. This implies that every unit of rupee can buy fewer goods and services as an economy witnesses inflation.

**There are two types of inflation: demand pull inflation and cost push inflation.**

1. **Demand pull inflation:** This happens when the demand for goods and services is greater than their supply. This excess demand tends to push prices up. Its main causes are:
  - a. **Increase in disposable income of the consumer:** this results in increase in purchasing power and hence greater demand for goods and services e.g. the implementation of 6<sup>th</sup> Pay Commission enhanced the purchasing power of many government employees.
  - b. **Increase in population:** this raises the number of consumers in the market and hence the total demand.
  - c. **Growth in black money:** Illegal and unaccounted for money leads to higher consumption as this money is difficult to save in bank accounts etc.
  - d. **Increase in money supply:** RBI may increase money supply in the economy through its monetary policy by lowering the CRR or SLR. This raises the circulation of money in the economy and in turn the demand for goods and services.
  - e. **Increase in Government expenditure:** public expenditure e.g. on Commonwealth Games, increases the demand for many goods and services.

## 2. **Cost push inflation**

This occurs at the supply end of the commodity, raising its cost of production. This kind of inflation spreads from one industry to another as they are interdependent.

- a. **Higher wage rates:** when wages and salaries increase, the producers shift this burden to their consumers who eventually pay the increased price of the product. This increases the cost of living and labour demands higher wages to fight increased cost of living. It leads to a further increase in wages and salaries. This is termed as **wage spiral**.
- b. **Higher profit margins:** when producers increase their profit margins, prices of commodities go up.
- c. **Shortage of inputs:** a fall in the supply of inputs e.g. decline in procurement of coffee beans due to frost, increases the cost of production.
- d. **Increased tax structure:** when sales tax, excise duty, VAT increases, the cost of production may go up and hence the price of the commodity.

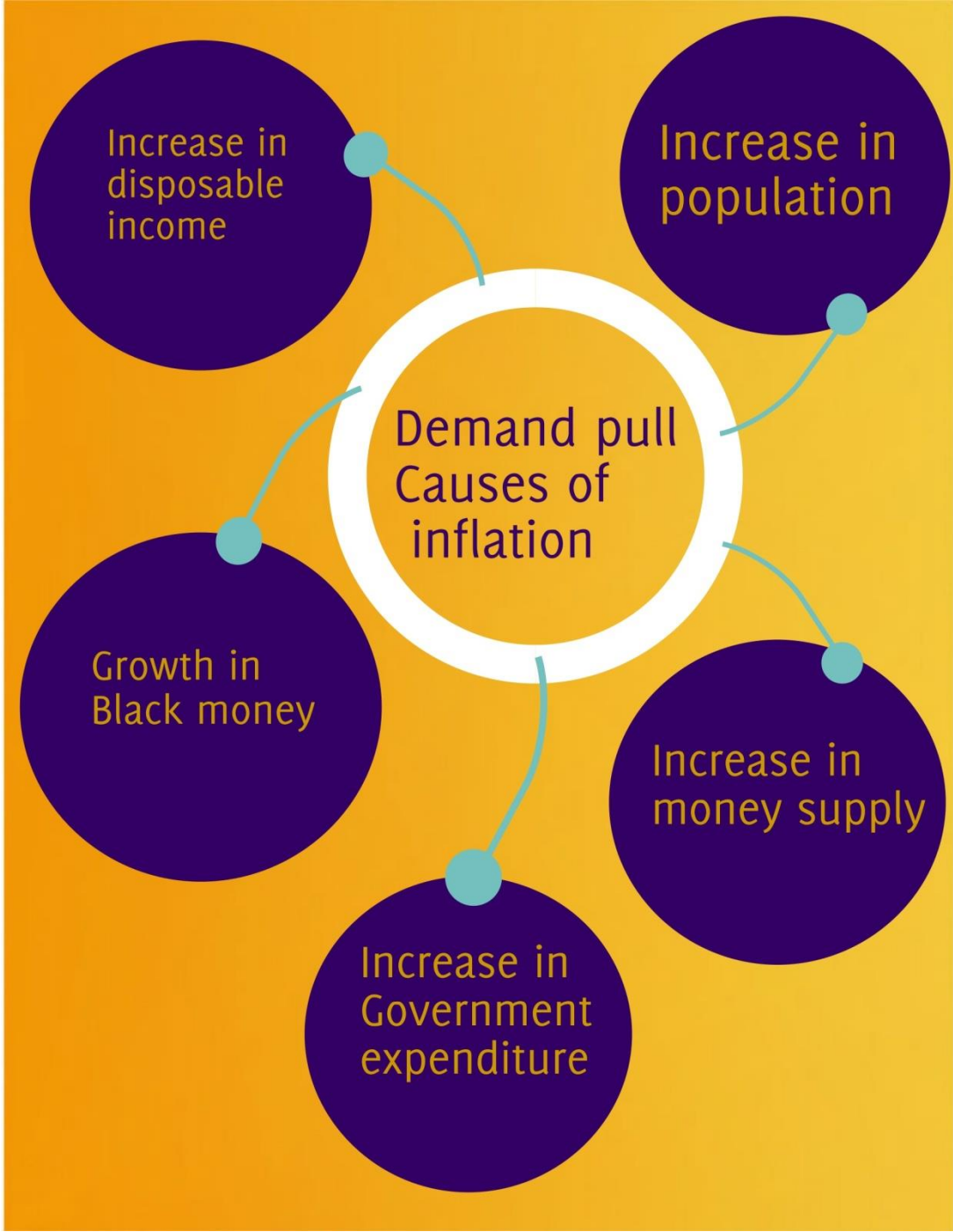
## Causes of inflation:

### Demand factors leading to inflation

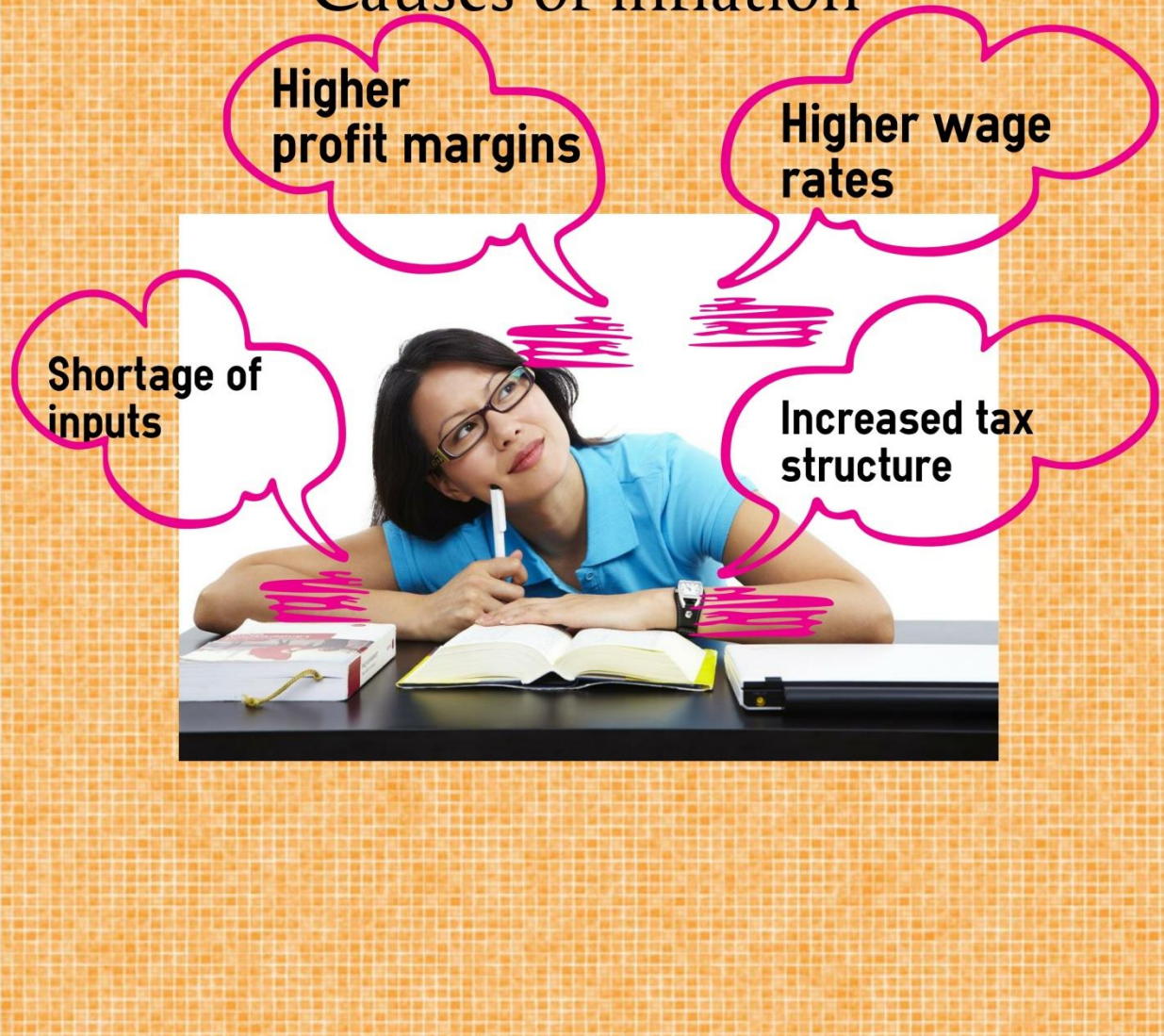
1. Growth of population
2. Rise in income and Employment
3. Increasing pace of urbanisation: leads to increase in demand for luxury goods due to migration and **demonstration effect**.

### Supply factors leading to cost push inflation

1. **Irregular agricultural supply:** due to dependence on monsoons or lack of irrigation.
2. **Agricultural price policy:** the government's policy of minimum support price raises price of agricultural goods, in a bid to help the farmers.
3. **Hoarding and Black marketing:** traders and big farmers hoard essential commodities like onions, oil, medicines and even food grains to create artificial scarcities. This raises the price of the commodities.
4. **Inadequate industrial production:** when the demand for manufactured goods cannot match the growing demand for the same, it pushes up the price of industrial goods.
5. **External factors:** rise in price of imports especially crude oil, machinery, raw materials raises the cost of production and eventually the price of goods.



# Cost push Causes of inflation



Student's Activity: Sort the following factors under the demand pull and cost push factors:

1. Rise in population.
2. Oil price hike.
3. Increase in money supply.
4. Deficit financing by the government.
5. Rise in administered prices.

6. Black money.
7. Rise in wages.
8. Higher profit margins.
9. Shortage of inputs.
10. Increased taxes.
11. Increase in government expenditure.
12. Increase in disposable income of people.
13. Fall in production.

Answers;

Demand Pull Factors:

1. Rise in population.
2. Increase in money supply.
3. Deficit financing by the government.
4. Black money.
5. Increase in government expenditure.
6. Increase in the disposable income of people.

Cost Push factors:

1. Oil price hike.
2. Rise in administered prices.
3. Rise in wages.
4. Higher profit margins.
5. Shortage of inputs.
6. Increased taxes.
7. Fall in production.