Asian Journal of Managerial Science
ISSN: 2249 - 6300 Vol. 3 No. 1, 2014, pp.7-11

Inflation in the Indian Economy

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(Received on 15 March 2014 and accepted on 15 June 2014)

Abstract – **Inflation is one of the most retarding factors of economic life and economic development. In fact, it affects almost all economic activities as well as consumption pattern of average and poor people. Since 1947, prices have continuously risen in India. It is seen that fluctuations in prices create an atmosphere of uncertainty which is not conducive to the developmental activities. In other words inflation creates uncertainty in development activities which cause a decline in the purchasing power of money. At the same time, stability in the price level is conducive for economic stability. It is quite interesting to note that what India experiences in instability in the price level are different from Keynesian view who stated that inflation occurs after the achievement of full employment level. But it is not so in India where increase in government expenditure is the major cause to inflation. Hence, the investigators attempt to analyze the inflationary trend and growth of public expenditure in India over a period of time. The fluctuation in price level is measured in terms of wholesale price index or consumer price index.**

Keyword: **Price stability, peace time inflation, public expenditure, whole sale price index and consumer price index.**

I. Introduction

Everywhere inflation has become one of the chronic economic problems, which affects the development of individual and society. So, an empirical analysis of causes of inflation and its impact on growth has received much attention in macroeconomic research in the recent decades. Inflation indicates persistent rise in the general level of prices.[1] It is seen that a myriad of factors related to inflation are growth of population low production and excess demand for goods and services, exports, inequality in income distribution, failure of fiscal and monetary policies, and deficit budgeting or increasing public expenditure. It is important to note that the role of government quite important in a welfare state. In fact, the government adopts deficit budgeting whenever if implements various schemes for the welfare of the people. Hence, increase in public expenditure has become quite unavoidable in India. However, the causes of inflation are different from developed countries to developing one. This is because peace time inflation very often occurs during a planned economic development in an underdeveloped economy. This type of inflation is the result of increased governmental expenditure on ambitious developmental projects. This article aims at analyzing the growth of public expenditure and its impact on general price level.

Views of Economists about Inflation

Inflation is understood as a substantial and rapid general increase in the level of prices and consequent fall in the value of money over a period of time. Crowther defines inflation as “a state in which the value of money is falling, i.e. prices are rising”[2]. It is statistically measured in terms of the percentage increase in the price index as a rate per cent per unit of time – usually a year or a month. There are two distinct views on the concept of inflation. The earlier economists viewed that inflation is a pure monetary phenomenon, while to others, it is a post-full employment phenomenon. Hawtrey in his ‘Trade and credit’ gives the definition of inflation as “the issue of too much currencies”. Milton Friedman[3] and Goldnweiser regarded inflation as a pure monetary phenomenon. When money supply exceeds the normal absorbing capacity of the economy, leads to persistently rising prices. Inflation occurs when the volume of money increases faster-than the available supply of goods, when the growth of national income in money units is greater compared to its growth in physical units.

Keynes[4] regarded inflation as a post-full employment phenomenon. According to him, a rise in prices in all situation cannot be termed as inflation. In a situation of underdevelopment, when an increase in money supply and rising prices are accompanied by an expansion of output, income and employment, inflation does not occur. The rise in prices after the stage of full employment is reached in an economy is a case of true inflation.

Most of the people understand that inflation is a substantial and rapid general increase in the level of prices. A correct indicator of inflation should be not only the factors causing rise in price level but also show how these factors work themselves out and produce an inflationary situation

II. Review of Literature

Mahendra Dev and Jas Mooij (2002)[5] have observed that during the period of economic planning there has been a spectacular increase in the public expenditure. During the six decades from 1951 to 2011 passing through the second stage of demographic transition, India has faced population explosion. In 1951 the population of India was 36 crore which has risen to more than 120 crores in 2011. Growth of population on this scale will certainly require an increase in public expenditure.

Pratima Sing (2011)[6] analysed the tread inflation over the past five years, particularly food inflation, and examines the demand and supply side factors behind surging food prices. The study argues that demand for several food items in India exceeds their current supplies and leads to higher prices.

Prasanna Salian and Gopakumar (2012)[7] examined the relationship between inflation and Gross Domestic Products growth in India. They found that there is a long-run negative relationship between them. So, the study concluded that inflation is a harmful rather that helpful to growth.

Bhattacharya (1985)[8] carried out a study on public expenditure, Inflation and growth in India. They study revealed that the tradeoff between inflation and growth is a major issue in Economics and in developing countries. The problem rises mainly as a result of the deal roles played by public expenditure, which generates and employment on the one hand and deficit financing and which is triggering inflation.

III. Growth of Public Expenditure

In developing countries like India, increase in government expenditure is considered as important cause for rise in price and fall in the value of money. Increase in public expenditure results in increase in money supply. But, this increase in money supply is not followed by a corresponding increase in the supply of goods and services. Hence prices rise.

Inflation arises when a rise in demand takes place in an economy. During the planning period[9] when the public sector investment or government expenditure on public development programmes increases and the total demand naturally rises. Investment expenditure of the entrepreneurs may increase contribute to rise in demand. This may mean that rise in price is due to plan or growth induced. This situation is also referred as peace time inflation which may not be called as real inflation.

Table I Combined Public Expenditure of Union and State Governments and Union Territories During 2000-01 to 2010-11 (in Crores)

Year	Total Revenue and Capital Expenditure at Current Prices	Growth Rate
2000-01	588233	10.1
2001-02	644336	9.5
2002-03	694690	7.8
2003-04	784664	13.0
2004-05	856882	9.2
2005-06	959855	12.0
2006-07	1108174	15.5
2007-08	1316246	18.8
2008-09	1599533	21.5
2009-10	1852296	15.8
2010-11	2240369	2.1

Source:

1. Reserve Bank of India, Handbook of statistics on the Indian Economy, 2009-10., Mumbai, 2009, Table 115, P. 204.3
2. Economic Survey of India 2011-2012 Government of India, Delhi, 2012, Table 3:12, P. 71.

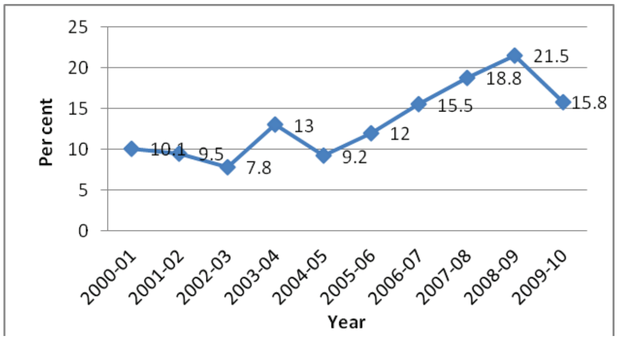

Fig. 1 Growth of public expenditure

Table I shows the growth of public expenditure of central and state government. After the independence of the country, the government has increased its expenditure with a view to increase agricultural and industrial production and service sectors. Consequently, the total public expenditure increased from Rs. 900 crore in 1950-51 to Rs. 7843 crores in 1970-71, and to Rs. 163520 crores in 1990-91. Thus the public expenditure has been steadily rising. In 2000-01 it was Rs. 588233 crore and in 2010-11 which was amounted to Rs. 2240369 crore. Obviously, it is quite impressive as this rise in public expenditure. The vital reason for the rise in the public expenditure during economic planning period has been due to the expansion of developmental activities in the country.

Inflation Trends in India

Inflation in India was computed by "Wholesale Price Index" which has remained moderate from 1950. Table II reveals the inflationary trends in India over a period of time. It is observed from the study that a continuous and sustained upward movement of the general price level is described as peace time inflation.

It is evident from the Table II that the rise in general price level was very low. The inflation was very low to a positive value of 13.8 per cent.

It is noted that during 1974-75 inflation was recorded the maximum at 25.2 per cent. The failure of Kharif crop and rise in oil prices were the major contributory factors for inflation. In the subsequent year 1975-76, inflation witnessed a negative trend at -1.09 per cent. This was as a result of strong anti inflationary measures taken by the government. But during the 1980's the highest inflation of the decade was 18.2 per cent. On the other hand the ninetees witnessed resurgence of inflationary tendencies. The positive impact of reform measures on prices were undertaken by the government. As a result, the inflation trend was 10.3 per cent in 1990-91.

Table II Inflationary Trends in India

Year	Inflate on (WPI) (Percentage)	Growth Rate
2000-01	1.8	-
2001-02	3.6	-50.0
2002-03	3.4	-5.6
2003-04	5.5	61.8
2004-05	4.4	-20.0
2005-06	4.1	-6.8
2006-07	5.4	31.7
2007-08	4.7	-13.0
2008-09	8.4	78.7
2009-10	1.6	-80.6
2010-11	2.0	31.8

Source:

1. Economic survey various issues
2. Central statistical organization, Government of India.

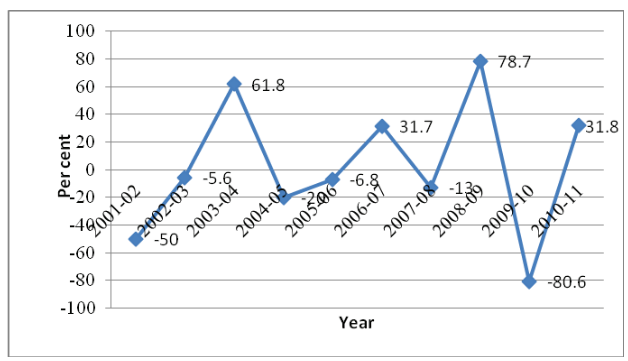

Fig. 2 Inflationary Trends in India

It is evident from the table II that in 2001, inflation trend started to decline and reached 1.8 per cent. However, it rose to 3.6 per cent in 2002. This trend continued to increase upto 2007 but declined in the year end (2007-2008). It is important to point out that inflation had reached highest level of 8.4 per cent in 2008-2009. The inflation turned negatively as 1.6 per cent by the year 2009-10 owing to the impact of recession in the global trend and thereby it was 2.0 per cent in 2010-11.

It is observed from the study that there is a relationship between the increase in public expenditure and rise in general prices. A positive relation exists between public expenditure and inflation. The public expenditure has increased at a growth rate of 7.8 per cent only in 2001-02 and the negative growth rate of -50 per cent of inflation has been witnessed for the same year. In 2010-11, public expenditure increased at the rate of 29.8 per cent while in the case of inflation, the rate was 31.8 per cent. This reveals the fact that rise in prices is due to development induced. Such a price rise is considered by Keynes as 'semi inflation only". When once full-employment stage is reached, the excess of investment or government expenditure will lead to excess demand, as output could not be increased with it, and prices will rise. This rise in price level is regarded as 'pure inflation'.

Impact of Inflation

Inflation has adverse effect on social and economic life. It can be highlighted in the following grounds.

1. Inflation causes many social evils[10] such as corruption, hoarding, black marketing, adulteration and production of substantial commodities.
2. It increases financial burden of the government. It is seen that the public debt has increased from Rs. 154004 in1991 to Rs. 2703844 in 2011[11].
3. It widens the gap between inequalities in income and wealth distribution. It causes adverse balance of payments in the international trade.
4. It increases small savings, deposits and provident fund from Rs. 61771 crores in 1991 to Rs. 590809 crores in 2011.[12]
5. It pushes the workers to demand higher wages which leads to strike and low production.

IV. Findings

The following findings are drawn from this study.

1. The inflationary views of western economists are not applicable to Indian context. India is experiencing peace time inflation over a period of time.
2. In India the general price level has been increasing before reaching full employment which is referred as peace time inflation.
3. Growth of public expenditure leads to rise in price level. It not only acts as a balancing factor of saving and investment, it is an important tool during the period of planed economic development.
4. Public expenditure is for the development of infrastructural facilities like power projects, railways, roadways and irrigational projects which is very essential for economic development. One the other hand expenditure on defense, and other non productive items cause rise in general price level.

V. Recommendations

The following recommendations are suggested to control inflation in Indian economy.

1. Government should minimise it's expenditure incurred on wages, salaries and other monetary benefits given to the employees both in government and private aided organizations.
2. It should stop the provision of free articles irrespective of economic conditions of the beneficiaries.
3. Expenditure and monetary benefits on nonproductive items may be reduced wherever and whenever necessary.
4. Annual increment and academic incentives may be avoided because it focuses on monetary benefits rather than intellectual development.

VI. Conclusion

It is concluded from the study that the causes of inflation differ from developed to under developed countries. In fact, inflation takes place only at the stage of full employment while in the case of developing countries the growth of public expenditure exceeds the supply of goods and services. Hence, the government should minimize its expenditure on non-productive purposes and to regulate monetary and fiscal policies to control inflation in India. Public expenditure accelerates investment in the public sector. It should be spent on the perfect coordination on various sectors to realize the objectives of the economy. Besides, public expenditure management should correct the burden of the fiscal deficit of the government.

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