inflation and galloping inflation or hyper inflation. The inflation is said to be *creeping*, if the prices per decade rise at a rate of 10 percent. The inflation is called as *walking*, if the price level rises per decade at the rate of 30 to 40 percent. The inflation is said to be *running*, if the price leves rises at the rate upto 100 percent per decade. The inflation is said to be the *galloping or hyper-inflation*, if the price level rises at a rate over 100 percent per annum.

(viii) Demand-pull or excess demand inflation : The inflation is said to be demand pull and excess demand inflation, when the price increase is not only initiated by the increase in demand for goods and services, but the subsequent increase in price is also caused by the further pull of demand or increase in excess demand. For a more detailed study of demand-pull inflation, refer to Section 4.

(ix) Cost-push Inflation : The inflation is regarded as cost-push or wage push inflation, if the increase in prices of products is not only initiated by the push of costs and wages but the subsequent rise in prices is also perpetuated by the push of costs and wages. For a more detailed study of this type of inflation, refer to Section 4.

(x) Profit-push inflation : Sometimes the inflation is neither caused by the pull of demand nor by the push of wages and costs, it is caused by the tendency of business men to raise the prices of products in order to secure more and more profits. Such inflation is termed as profit-push inflation.

4. DEMAND-PULL AND COST-PUSH THEORIES OF INFLATION

I. Demand-Pull Theory of Inflation

According to the demand pull theory of inflation, the process of rising prices is initiated by the excess of demand over supply to goods and services in the economy. Later on further excess of demand over supply continues to exercise demand pull and the price level continues to move in the upward direction. Suppose the economic system is initially in a state of full employment equilibrium. The aggregate supply of output becomes fixed or perfectly inelastic in such a situation. Now suppose the aggregate demand increases due to any or several of the factors mentioned below :

(*i*) Increase in the quantity of money.

(*ii*) Increase in the velocity of money.

(*iii*) Increase in the flow of credit.

(*iv*) Increase in consumption.

(*v*) Increase in investment.

(*vi*) Increase in government expenditure.

(*vii*) Increase in foreign demand.

The excess of aggregate demand over aggregate supply causes the bidding up of prices. Thus the excess demand or demand pull initiates the increase in price level. As prices increase, consumers and producers expect that the prices will rise even in future. They start making purchases not only for the current period but also for the future. Thus there is further pull of demand and price level continues to increase. So long as the excess demand or the demand-pull continuous to exist, the process of inflation will persist in the economy.

Keynes' inflationary gap analysis is also a variant of the demand pull or excess demand inflation. The *inflationary gap* is the excess of anticipated expenditure over the available supply of output at base prices or the pre-inflationary prices.

The demand-pull inflation or excess demand inflation can be explained with the help of Fig. 1.

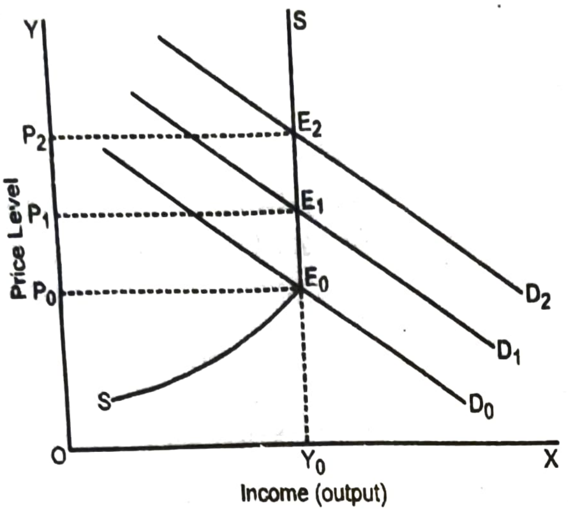

Fig. 1

In Fig. 1 income or output is measured along the horizontal scale. The price level is measured along the vertical scale. Originally, SS is the aggregate supply function which is relatively more elastic before the full employment income or output Y_0 and becomes perfectly inelastic or a vertical straight line at the full employment income or output Y_0. D_0 is originally the aggregate demand function which slopes negatively. Initially, equilibrium income is Y_0 and the price level is P_0. In this situation, the economy is in equilibrium at full employment. If there is increase in money stock and credit, increase is consumption, investment or government expenditure, the aggregate demand function shifts upto D_1. Now the equilibrium takes place at E_1 where economy remains at the full employment income or output Y_0 but the price level rises to P_1. Consumers and producers expect that prices will rise also in future. They will start making anticipatory purchases. It will further raise the aggregate expenditure so that the aggregate demand function further shifts upto D_2. Now the intersection between the aggregate supply function SS and the aggregate demand function D_2 takes place at E_2. The economy even in this equilibrium position remains in a state of full employment but the price level rises further to P_2. Thus in the demand-pull or the excess demand inflation, the process of rising prices is not only initiated by the pull of demand but is also perpetuated by the pull of demand.

II. Cost-Push Theory of Inflation

The alternative explation of inflation is in terms of push of wages and costs.

In there is initially an increase in money by wages of the workers, the cost of production increases because wages are a part of the cost of production. As costs increase, the producers raise the prices of finished products in order to maintain their profit margins. As prices rise, workers feel that they have become worse off than before. In order to maintain their standard of living, they are forced to demand higher wages. As the higher wage claims of workers are conceded by the employers, there is again an increase in costs and prices. Thus wage-cost-price spirals continue to operate in the economy due to persistent pushes of wages and costs. Apart from the push of wages, the increase in the prices of other factor inputs can also initiate and perpetuate the cost push and the consequent increases in the price level. The cost-push or wage-push inflation can be explained through Fig. 2.

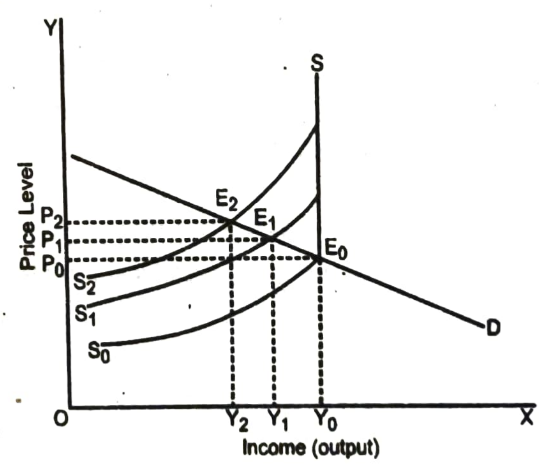

Fig. 2

In Fig. 2, D is the aggregate demand function which slopes negatively. S_0S is originally the aggregate supply function. It is more elastic before full employment but becomes perfectly elastic at the full employment income Y_0. Their intersection at E_0 determines the full employment income Y_0 and price level P_0. If there is increase in money wages and costs, the aggregate supply function shifts to S_1S. Its intersection with the aggregate demand function take place at E_1 where the equilibrium income or output Y_1 falls below the full employment income Y_0 and the price level rises to P_1. Y_0Y_1 is the unemployment gap. The increase in price level makes the trade unions to put pressure further so that the living standard of workers is kept intact. As the employers increase the money wages, there is again an increase the costs and the aggrage supply function again shifts upto S_2S. The intersection between S_2S and the aggregate demand function D takes place at E_2. Now the equilibrium price level rises further to P_2. The unemployment gap in this case rises from Y_0Y_1 to Y_0Y_2. This process of rising prices and increasing unemployment goes on so long as the cost-push is present. The characteristic feature of cost-push or supply inflation is the co-existence between rising prices and increasing unemployment. In contrast, the economy remains fixed at the level of full employment and price level alone continues to increase in the case of demand-pull or excess demand inflation.

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