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.

5. EFFECTS OF INFLATION

A moderate rise in prices creates stimulating economic environments. The increased investment activity promotes production and employment. The community does not feel the necessity of restraining this slow increase in prices, since it tends to ignore the long term impact of this rise in price level. As the rate of increase in prices undergoes changes, the evil effects of inflation become more pronounced and the government is compelled to adopt anti-inflationary measures in view of the miseries and sufferings inflicted by inflation upon the community. The costs of inflation upon the economic system and social life of the people can be assessed through the following effects :

(*a*) Effects on economic activity.

(*b*) Redistributive effects.

(*c*) Social, political and moral effects.

(a) Effects on Economic Activity

A moderate rise in prices, opines Keynes, has beneficial effects upon the economic activity particularly before full employment, when there is unutilised or underutilised productive capacity in existence in the economy. Rising prices generate optimistic expectations among the businessmen, since more profits are available to them on account of the lag between rising prices and cost of production. The rising profits induce greater investment activity and there is a consequent expansion in income, output and employment. Such a stimulating effect of rising prices upon the general economic activity exists, till the full employment ceiling is reached. As soon as the system approaches the limit of full employment of resources, no further expansion in output and employment can be possible. The rate of increase of prices also gathers momentum and more and more uncertain conditions prevail in the economy. The beneficial effect of rising prices at this stage stands nullified and the evil effects manifest themselves. These may be briefly stated as under :

(*i*) ***Distortion of price mechanism*** : The existence of inflationary pressures results in the distortion and disruption of the price-mechanism. These pose formidable hindrances to the smooth and harmonious adjustments among the different economic variables in the economic system.

(ii) Hindrance in capital formation : The process of capital formation is seriously jeopardised by the rising prices. As the purchasing power of money decreases, the people are no longer inclined to increase their savings. Not only the willingness to save, but the capacity to save is also adversely affected by the rapidly rising prices and the stiffer doses of taxation that accompany the process of inflation. Thus capital accumulation is hindered by inflation. Even the available capital resources are likely to be driven out of the country.

(iii) Uncertainty and confusion : An inflationary situation creates a lot of uncertainty and confusion in the economic system. As the skills, energies and resources of the business community are diverted more and more to speculation for earning quick profits, the genuine productive activity is badly affected. Inflation invites businesses to seek profits via manipulation of markets rather than through efficient production.

(iv) Hoarding and black marketing : During the inflationary times, as the prices increase, it becomes more and more profitable to hold larger stocks of goods. Thus the propensities to hoard get strengthened. With an increase in hoarding of goods, the availability of goods in the market progressively decreases while the money income continues to rise. This has a strong tendency to push up the prices further. Any attempt on the part of the government to control prices gives rise to the phenomenon of black marketing.

(v) Adverse effect on pattern of investment : The process of rising prices has quite adverse repurcussions on the pattern of investment. *Firstly,* a larger proportion of investment is of the type of speculative financial investment. *Secondly,* there is a pronounced preference for such projects or industries as can yield return within a short period. Generally such projects turn out consumption goods. The development projects having longer gestation lag are widely on the discount. In this way, the development potential of the economy is unfavourably affected. *Thirdly,* a diversion of resources takes place from the production of essential commodities to the production of the goods for conspicuous consumption. Such changes in the pattern of investment, have a detrimental effect upon the level of economic activity in the country.

(vi) Deterioration of quality of products : Inflation creates such a situation in the market in which selling activity predominates and anything that is placed in the market can be easily disposed of. Consequently, there is a general deterioration in the quality of production.

(vii) Inflexibility in the economic system : Inflation tends to reduce the mobility of labour and also the flexibility of the economic system. Since the allocation of labour and other co-operant factors does not take place on the basis of the expectations of profits and price calculations, particularly in the case of suppressed inflation, the given allocation of resources may get frozen and there is no guarantee that such an allocation is efficient.

(viii) Flight from currency : As the hyper-inflation develops, the continuous depreciation in the value of money reduces the liquidity preference to the minimum point such that the people want to get rid of currency at the earliest. The economic system thus faces a phenomenon of the flight from currency as was witnessed during the hyper-inflation in Germany.

It is thus clear that the existence of inflation renders the price system unworkable ; frustrates the capital formation ; creates extreme uncertainty and; brings about serious distortions in the allocations of productive resources. Hence inflation, by no means, can be regarded as conducive for the general economic activity in a country.

(b) Redistributive Effects

If the individual prices of current goods, productive factors, real and monetary assets and liabilities move together in the same proportion, the financial position of all individuals in the society will be left unaltered and the distribution of income and wealth among the individuals and various groups will remain unaffected. Such a perfect conformity among all the variables referred to above is, however, almost impossible to be realised in practice. When the general price level rises during the inflationary times, the individual prices change in a disproportionate manner and produce substantial changes in the distribution of income and wealth among different economic and social groups in the country. The redistributive impact of inflation upon various groups has been discussed below :

(i) Fixed income groups : Those people, who have to draw exclusively upon fixed wages, salaries or rents, are the fixed incomists. They include workers, clerks, government servants, teachers, pensioners, rentiers and the persons living on the past savings. As prices increase, the value of money depreciates and the real purchasing power of the fixed incomist middle class decreases, since a corresponding increase in incomes is not possible. Even when the trade unions among the wage-earners get the wage rates increased, the rate of increase in prices being greater than the rate of wage increases, the wage-earners are hit hard and there is an erosion in their standards of consumption. Even if the wage rates are linked up with the cost of living index, still the wage-earners are adversely affected because there is often a lag between the rise in prices and wages. The rentiers, pensioners and the salaried groups are much more handicapped because of the non-existence of stronger organisations among them. Not only the above categories, but the entire middle class, as a matter of fact, has to pass through the strains imposed by inflation.

(ii) Debtors and creditors : Debtors are generally benefitted by inflation while losses are inflicted upon the creditors. The reason for it is that the debtors make repayments in terms of money, the purchasing power of which goes down as compared to the time when the funds were borrowed. In real terms, they forego a smaller quantity of goods and services for the repayment of debts. Creditors, on the other hand, are the losers because they receive less in real terms than what they would have, were the prices low. Thus inflation tends to redistribute income and wealth in favour of the debtors and against the creditors.

(iii) Business community : The inflationary phenomenon generally has beneficial effects upon the business community including traders, producers and entreprenurs as the rising prices tend to raise profits. The value of their inventories increases in monetary terms. No doubt, the cost of inputs too goes up, yet the existence of a lag between the increase in prices and costs ensures excessive profits to these sections of the society. If an attempt is made by the government to fix the prices of the finished products, a large number of transactions tend to be conducted in the black market and the unscrupulous traders and producers get away with exorbitant profits. The producers of such commodities and services as electricity and transport services, the prices of which may be fixed conventionally or by law, gain little or nothing during the period of rising prices. As the cost of producing these commodities and services continues to rise, the inability on the part of the producers to raise the prices, by an equivalent extent, results in a progressively falling margin of profits and it becomes more and more difficult to maintain such services, unless their prices too are allowed to rise at least in proportion to the rise in their costs.

(iv) ***Investors*** : It is generally believed that the inflationary situation is quite favourable to the investing groups in the country. But this is not true for all the categories of investors. The low and middle class investors are likely to lose appreciably because they put their savings in the fixed interest-bearing securities, insurance and saving accounts. Fixed interest incomes and a depreciating value of money reduce all charm of saving. The debenture-holders also suffer because of the reasons given above. Among the investing groups, only the equity-holders stand to gain, since the return on equities rises with the rising prices. More and more dividends become available to them with a rise in the price level.

(v) ***Agricultural community*** : The agricultural community is divided into three broad categories— non-cultivating landlords, peasant proprietors and the farm workers. So far as landlords are concerned, they are adversely affected during the periods of inflation, since the rents are fixed by contracts over a long period of time. Consequently, as the other prices increase, rental incomes remaining fixed, the rentier class in the farming community becomes a loser. The peasant proprietors gain substantially during a period of rising prices, since the prices of food products as well as of the industrial raw materials move continuously in the upward direction. But the beneficial effect of the rising prices, to a certain extent, is eroded by the accompanying rise in the prices of farm inputs. The farmers, however, are still benefitted by inflation because the costs always lag behind prices. The farm labourers are very badly affected by the inflationary rise in prices, since these people receive very low fixed incomes and inflation causes more and more impoverishment among them. Another reason for the adverse effect of inflation upon them is the absence of trade unions among them. Consequently, they find it impossible to get their wages increased. The evil effects of inflation may, however, be diminished in intensity by the extent to which wage-payments are made in terms of farm products. In brief, the farming community, by and large, suffers when the price level gallops up.

The above discussion shows that inflation has a *differential impact* upon different economic and social groups. There are primarily two reasons why the redistributive effects of inflation are uneven. *Firstly,* the different groups have varying ability to foresee inflation. *Secondly,* there are differences in the abilities of various groups to adjust their economic behaviour to inflation. If every individual or group had equal ability to predict and adjust to inflation, it would have no redistributive effects. The entrepreneurs and producers have a great capability to foresee inflation and adjust their economic behaviour to it as compared with the lower and fixed income groups. Consequently, the latter are much more adversely affected by the vicious rise in prices than the former. The most unfortunate aspect of inflation is that it redistributes incomes and wealth in a most arbitrary way throwing the maxim of social equity to winds. Inflation is nothing short of a subtle robbery but it is perfectly legal and the community has to subsist with it so long as it is not effectively controlled. C.N. Vakil in this context remarks, "Inflation may be compared to a robber. Both deprive the victim of some possession with the difference that the robber is visible, inflation is invisible ; the robber's victim may be one or a few at a time, the victim of inflation is the whole nation; the robber may be dragged to a court of law, inflation is legal."

(c) Social, Political and Moral Effects

Inflation not only affects adversely the economic activity in a country, it disrupts also the social, political and moral fabric of the