B. Com. III Sem.

Inflation

Introduction:

Inflation is a global phenomenon. There is hardly any country in the capitalistic world which is not affected by the spectra of inflation. It is on account of this reason that, the concept of inflation on attracted the attention of the world economist. However, it is difficult to define inflation in a precise terms. Different economist defined inflation in different manner. In fact, there is a plethora of definitions for inflation.

The Layman, however understand by term 'inflation' as a sizeable & rapid increase in general price.

Definitions:

1. **Prof G. Crowther** defined inflation as a state in which the value of money is falling i.e. prices are rising.
2. **Prof. Hawtrey** defines inflation as the "issue of too much currency". Therefore this is a vague definition it does not explains what is 'too much'.
3. **Prof. Coulburn**, "inflation is a situation where too much money chasing too few goods"
4. **Prof. Kemmerer** defined "inflation as too much currency in relation to the physical volume of business being done".
5. **Goldenweiser** "Inflation occurs when the volume of money actively bidding for goods & services increases faster than the available supply of goods"
6. "Inflation is always and everywhere a monetary phenomenon" – **Milton Feredmer**
7. **A. C. L. Day**, "inflation consist of a process of rising prices"

8. **P. A. Samuelson** " By inflation we mean, a time of generally rising prices for goods, factors of production rising prices for bread, cars, haircuts, rising wages, rent, etc."
9. **Edward T. Shapico** – "The obvious definition of inflation is that, inflation is a rising price level"
10. **Mitchael R. Edgmand**, "Inflation is a general and continuing increase in prices. This does not imply that all prices are rising some prices may even be falling, the general trend must be upward. The rise in prices must also be continuing once & far all price increases are excluded"
11. **Gardner Ackley**, "We define inflation as rising prices, not as 'high' prices. In some sense, then inflation is a disequilibrium state"
12. **Emile James** – "Inflation is a self-perpetuating & irreversible upward movement of prices caused by excess demand over capacity to supply"

Features of Inflation:

1. It is a monetary phenomenon
2. Persistent rising prices
3. Falling value of money
4. It happens in long-period
5. It is a economic concept
6. It is a post – full employment phenomenon
7. Inflation may be demand – pull or cost push
8. A cyclical movement of price is not inflation

Types of Inflation:

1. Money Inflation & Price Inflation:

Prof. Paul Eiazig makes a distinction between money & price inflation,

Money Inflation occurs at the initial stage such expenditure of money supply takes place.

Price Inflation is the next stage where dd ↑ MS. At this stage money supply fails to keep pace with rate of increase in price.

Therefore, price increase rapidly but MS ↑ slowly

2. **Demand – Pull & Cost Push Inflation:**

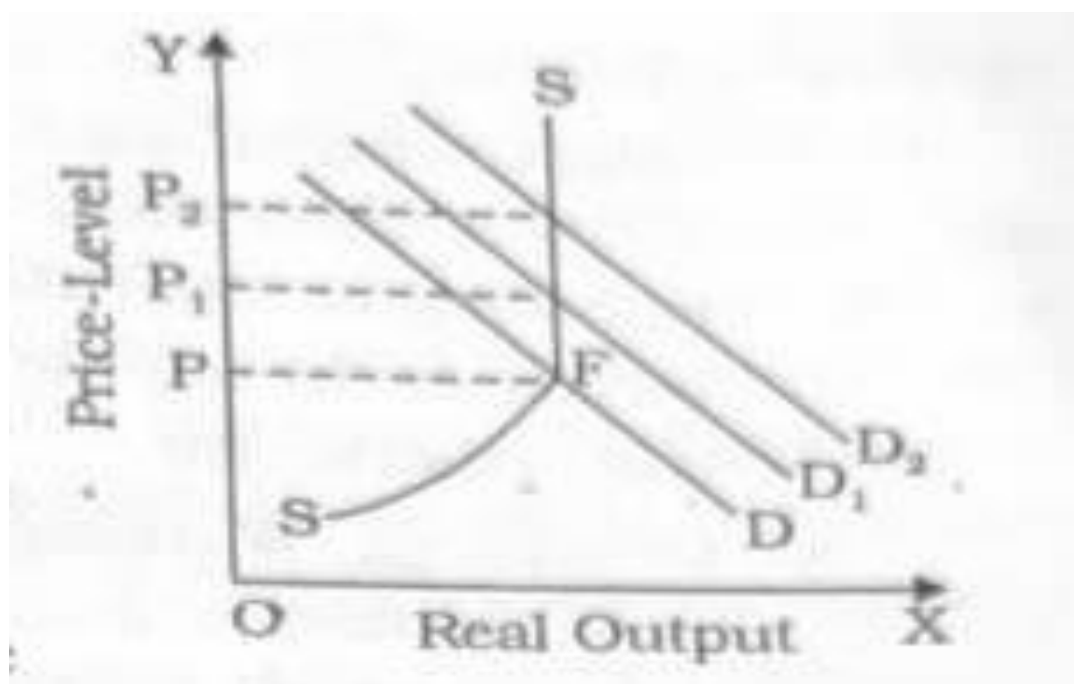
"Demand – pull – inflation occurs when price increases on account of the excess of aggregate demand over the existing supply of goods.

It is due to increase in the volume of MS when the economy is at a full employment stage.

Therefore, at full employment ↑MS → ↓ri → ↑investment → ↑income of factors of production → ↑ effective demand.

DD full inflation also occurs without any increase in the quality of money.

When MEC ↑ → Investment ↑ → ↑ Effective Demand → ↑P



D, D1, D2 are different levels of aggregate demand.

SS – Aggregate Supply Curve

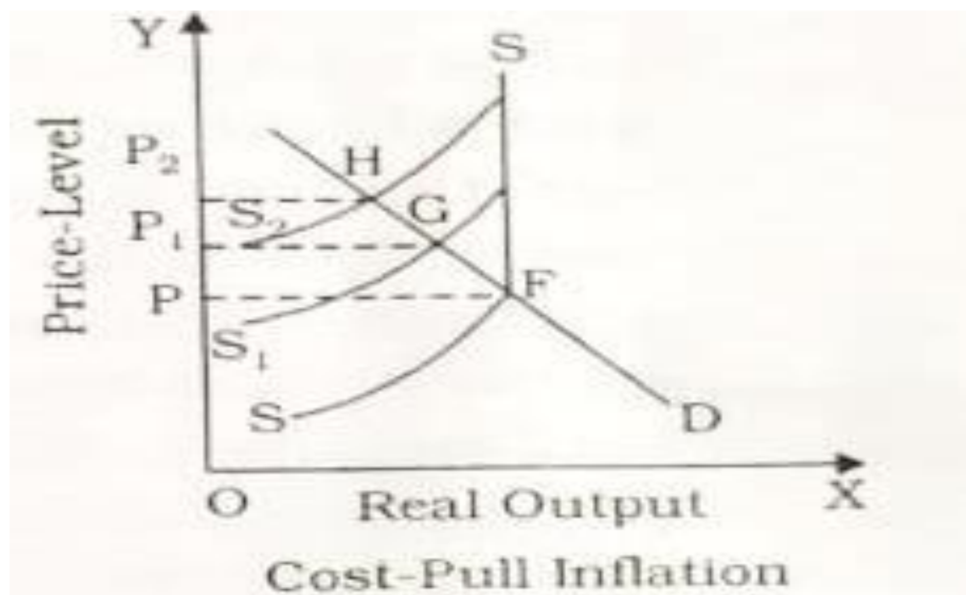
F – Full Employment Level

After point F supply becomes inelastic. A shift in demand due to autonomous investment (K) or C + I + G leads to increase in price.

Cost – Push Inflation:

Cost push inflation refers to a situation whereas price rises on account of increasing cost of production. For any reason price of factor ↑, cost of production also ↑

Increase in cost of production either due to wage – push or profit push.



DD – Aggregate Demand

SS – Aggregate Supply Curve

DD & SS inter section at point F determines OP price. The supply curve shifts to S1 S & S2 S due to increase in cost of production. Therefore, price ↑ to OP, & OP2, cost push may be due to wage – push. Money wages increase due to trade unions.

3. **Open or Suppressed inflation:**

   Open inflation refers to a situation where price rises without any interruption or the government.

   Suppressed Inflation or the other hand is a situation more government actively intervenes to check rising price through price ceiling.

4. **Inflation on the basis of intensity of price:**

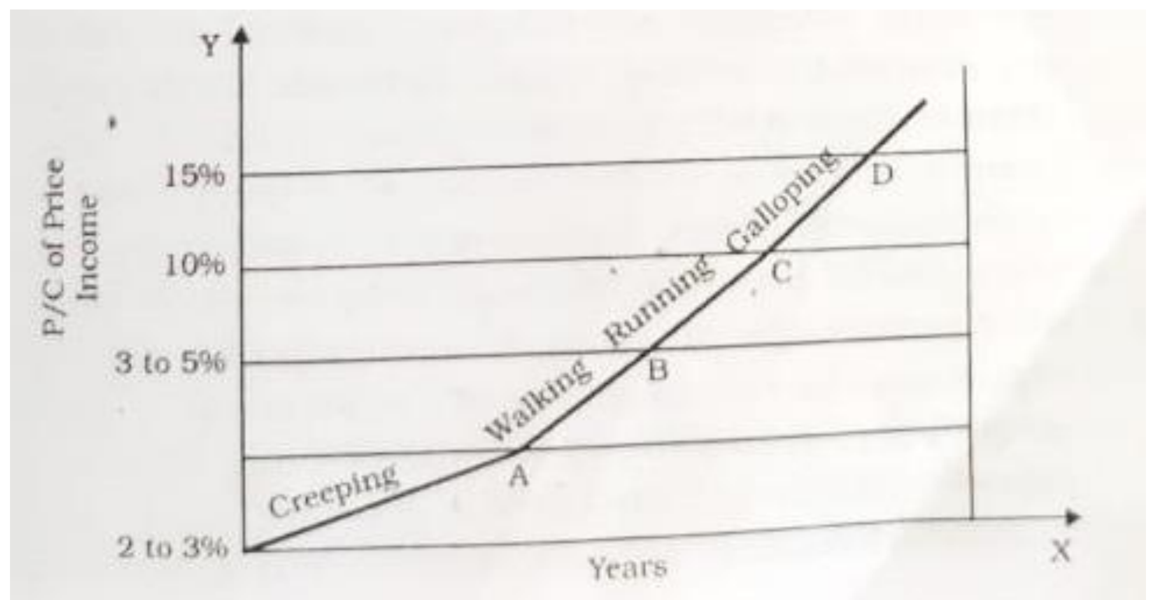
   (i) Creping Inflation: Where price increase at mild rate, i.e. 2 – 3% pa it is advantages to economic development.

   (ii) Walking Inflation - Price increases by 3 to 5% pa.

   (iii) Running Inflation – Price increases by 10% pa. Government fails to control price at this level.

   (iv) Galloping Inflation (Hyper Inflation): Price increases by 15% to 20% pa. Happened by France in 1924

   "A bucket full of currency earlier a pocket full of goods:



5. **Comprehensive & Sporadic Inflation:**

   On the basis of scope or coverage comprehensive inflation occurs, when entire economy experienced inflation situation.

   Sporadic on the other hand is a sector wise inflation. It is due to short supply of goods in certain section.

6. **Wage Induced & Deficit Induced Inflation**

   Due to increase in wage rate on account of collection bargaining of TV's

   Deficit induced inflation is due to government expenditure > revenue

7. **Inflation of the basis of time.**

   A) War time inflation

   B) Post war time inflation

   C) Peace time inflation

8. **Credit Inflation:**

   On account of excess credit creation by bank

9. **Profit Induced Inflation:**

   Due to profit motives of the monopolist

10. **Scarcity Induced Inflation:**

11. **Ratchet Inflation:**

    During decreasing trends in price, fixing the price at certain high level deliberately is known as ratchet

Causes of Inflation:

Inflation occurs on account of number of factors. These factors either related to demand side or supply side. Role of expectation also play an important role.

I. Factors on Demand Side

II. Factors on Supply Side

III. Role of Speculation

I. Factors on Demand Side:

1. Increase in money supply
2. Increase in public expenditure
3. Increase in private expenditure
4. Reduction in tax rate
5. Increase in exports
6. Payment of past internal debt
7. Rapid growth of population
8. Increase in net disposable income

II. Factors of Supply Side:

1. Shortage of supply of factors of production
2. Hoarding by traders
3. Hoarding by consumers
4. Operation of the law of diminishing returns

III. Role of Expectations:

Excess spending due to speculation.

Effects of Inflation:

Effects of inflation are felt universe by differed factors of the economy. Long and continuous inflation disturb the economy, economically, politically, socially and morally.

Therefore,

I. Economic Effects

II. Social Effects

III. Political Effects

I. Economic Effects:

a) An production
b) An Distribution

a) **An Production**: Keynes said mild / creeping inflation has favorable effects. Slow rise in price creates optimism among business community.

∴ ↑P → ↑ Investment → ↑ Employment → ↑ Output → ↑ Income = Economic development

b) **Effects on distribution**: On different class of income receives it affect differently.

i) Debtors & Creditors: Debtors are benefited creditors put to lose money value ↓
ii) Investors: Investors in equities will gain but those who invest in bonds will lose.
iii) Business Community: They will gain due to 'wind – fall profit'
iv) Wages & Salary earners: Wage may not increase at par with price. Therefore, the growth will lose.
v) Renties Class: Fixed income group likes pensioners, annuity holders, etc. will lose
vi) Farmers: Will gain due to ↑ price
vii) Consumers: Will lose their purchasing power therefore lose.

Therefore effect of inflation is nicely concluded by K. K. Kurihara: "Inflation redistributes wealth & income such a way as to hurt consumers, creditors, small

investors, & low & fixed income groups and benefits businessmen, debtors and farmers.

II. Social effects:

1. It decreases business morality
2. ↑ Black Marketing & Hoarding.
3. Frustrates the consumers
4. Increases tax burden
5. ↑ strikes and lock-outs
6. Social instability due to gap between riches and poors

III. Political Inflation

Hitler became dictator of Germany because of hyper inflation of 1920.

"Inflation is a Day Robbery"

Control of Inflation:

There is every danger that inflation may turn into hyper-inflation, if it is not controlled in the initial stage. Measures taken by the government to control inflation is known as anti-inflationary measures. viz.

1. Monetary measures
2. Fiscal measures
3. Other measures

1. Monetary Measures

Milton Friedman a modern economist suggests this measure. Monetary policy refers to Central Bank operations

a) Bank rate policy: ↑ Br → ↑ ri → ↓ Borrowings → ↓MS
b) Open market operation: It is a sale & purchase of government security by the Central Bank. Government will sell gilt edged securities in market. Money will come back to government.
c) CRR: Used by the USA in 1963 – minimum reserve ratio to be maintained by the commercial banks
d) Selective Credit Control:
   i) Margin Requirement
   ii) Consumer Credit control
   iii) Credit Rationing
   iv) Direct Action
   v) Publicity
   vi) Moral suasion

2. **Fiscal Measures**: Government policy with reference to public expenditure & taxation. J. M. Keynes advocated & popularized this measures.
   i) Increasing tax rate
   ii) Introducing new tax
   iii) Reducing public expenditure
   iv) Debt management
   v) Over-valuation of currency with reference to foreign currency ∴ ↓ expenses ∴ its leads to ↓ export ∴ ↑ supply of goods ↑ imports
3. **Other measures**: i.e. Direct measures
   a) Expansion of output
   b) Anti-hording Act & Anti-speculation Act
   c) Rationing & price control
   d) Wage cut policy

Core Inflation

Represents the long-run trend in the price level. In measuring long-run inflation, transitory price changes should be excluded. One way of accomplishing this is be excluding items frequently subject to volatile prices like food and energy.

∴ Core Inflation = CPI – Volatile Food & Energy Components.

Headline Inflation:

Headline inflation is a measure of the total inflation within an economy, including commodities such as food and energy prices which tend to be much more volatile and prone to inflationary spikes.

Headline inflation may not present on accurate picture of an economy's inflationary trend since sector – specific inflationary spikes are not likely to persist.

Hyper Inflation:

In economies hyper inflation is very high & typically accelerating inflation. It quickly erodes the real value of the local currency. Prices increases by 15-20% per annum.

Stagflation or Recession: Inflation in which the inflation rate is high, the economic growth rate slows & unemployment remains at high level. It is stagnation + inflation.

Built-in-inflation: is a type of inflation that results from past events and persists in the present.

The built-in-inflation originates from either persistent demand-pull or cost-push inflation in the past. It then becomes a ‘normal’ aspect of the economy via inflationary expectations and the price / wage spiral.

Mild inflation: creeping inflation also known as mild inflation is as the name suggests a very too slow rise in prices of goods and services. If the price increases by 3% or less annually, it is known as mild / creeping inflation. Such inflation is not harmful to the economy & therefore it is known as healthy inflation.

Unit – IV – Banking - B. Com. III Sem.

Banking:

Introduction:

Banking as an independent business originated during the 14th C. in England. It was conducted mainly by a class of people called the "Jews of Lombardy" as they conduct banking business in the Lombardy street of England.

Earlier, they transacted their business on the benches (banco). They displayed their coins on these benches and when a bankee was unable to meet his obligation, his benco was broken to pieces. From this practice, the word 'bankruptcy' has been derived.

Definition:

According **to J. W. Gilbert**, the form bank is synonymous to the Italian word 'monte' meaning a mound or heap. Banking is a business which requires heap and money.

R. S. Sayers in his book modern banking contender that banks are institutions whose debts usually referred to as bank deposits are commonly accepted in final statement of other people's debts.

According to **G. Crowther** "A bankee is a dealer in debt – his own and other peoples"

Prof. Hart in his 'Law of Banking' "A banker is one who in the ordinary course of his business honours cheques drawn upon him by persons from and for whom he receives money an current account"

Types of Banks:

1. Commercial Banks
2. Industrial Banks
3. Agriculture Banks
4. Exchange Banks
5. Savings Banks
6. Central Banks

Functions of Banks:

I. Primary
II. Secondary
III. Agency Functions
IV. General Utility Services

I. Primary

1. Accepting Deposits
2. Advance Loan
3. Discontinues Bills of Exchange

1. Accepting Deposits

a) Current Account
b) Saving Accounts
c) Fixed Deposits Accounts
d) Recurring Deposits Accounts

2. Advance Loan

a) Cash Credit
b) Over Draft
c) Loans:
- Term Loans
- Participation Loans
- Personal Loans
- Collateral Loans

II. Secondary Functions

1. Agency Functions
2. General Utility Services

1. Agency Functions

a) Collection & Payment of cheques, bills of exchange, promissory notes
b) Remittances / transfer
c) Payment of insurance & taxes on behalf of customers
d) Trustee & execution of will
e) Purchase & sale of securities, collection of dividends
f) Executing standing orders of the customers
g) Correspondent agent & Representatives financially

2. General Utility Services:

a) Issue of letters of credit
b) Dealing i.e. Foreign exchange
c) Safe deposit vaults
d) Compiling statistical & business information

e) Under writing of loans

Interest:

In its simplest from ‘interest is the cost of borrowing money & normally expressed in terms of percentage. It may be fixed or variable rate of interest.

Real Interest Rate:

It is the rate of interest on investor expects to receive after allowing for inflations, eg. expected 5%, inflation 2% $\therefore 5 - 2 = 3\%$

Nominal Interest Rate:

Nominal Interest Rate of interest refers to interest rate before adjustment for inflation.

Multiple Credit Creation by Banks

The SBI, SBM, Canara Bank, Corporation Bank, etc. number of banks in banking systems. Suppose SBI receives Rs. 10,000 as deposit from the customer now the balance sheet of SBI

Balance Sheet of SBI

Particular	Liabilities	Particular	Assets
Deposit	Rs. 10,000	Cash Received	Rs. 10,000
Total	**Rs. 10,000**	**Total**	**Rs. 10,000**

Now SBI retains 10% cash reserve out of deposit received & remaining will be lent out as loan (10% of 10,000 = Rs, 1,000) therefore SBI keeps Rs. 1,000 as cash & lends 9,000. Now balance sheet

1) Balance Sheet of SBI

Particular	**Liabilities**	**Particular**	**Assets**
Deposit	Rs. 10,000	Cash Received	Rs. 1,000
		Loans & Investment	Rs. 9,000
Total	**Rs. 10,000**	**Total**	**Rs. 10,000**

Now suppose Rs. 9,000 will be deposited in SBM. It also keeps 10% cash (10% of 9,000 is Rs. 900) & remaining 8,100 will be lent out as loans.

2) Balance Sheet of SBM

Particular	**Liabilities**	**Particular**	**Assets**
Deposit	Rs. 9,000	Cash Received	Rs. 900
		Loans & Investment	Rs. 8,100
Total	**Rs. 9,000**	**Total**	**Rs. 9,000**

Suppose that loans of Rs. 8,100 now reaches to Canara Bank. It retains 10% cash & lend or investment the remaining amount

3) Balance Sheet of Canara Bank

Particular	**Liabilities**	**Particular**	**Assets**
Deposit	Rs. 8,100	Cash Received	Rs. 810
		Loans & Investment	Rs. 7,290
Total	**Rs. 8,100**	**Total**	**Rs. 8,100**

This loan of Rs. 7,290 will reach Corporation Bank as deposit. It retains 10% cash & lends reaming as loans to others.

∴ 4) Balance Sheet of SBI

Particular	Liabilities	Particular	Assets
Deposit	Rs. 7,290	Cash Received	Rs. 729
		Loans & Investment	Rs. 6,561
Total	**Rs. 7,290**	**Total**	**Rs. 7,290**

The process of credit creation continues until deposit becomes zero. The total loans created by the banking system would come to Rs. 9000 + 8100 + 7290 + 6561 + - - - -- - -- upto zero. The aggregate of this series comes to about Rs. 90,000. The original deposit of Rs. 10,000 comes to sum of Rs. 1,00,000.

i.e.

$$K = \frac{1}{r} \quad K = \frac{\frac{1}{10}}{100} \quad \therefore \frac{1}{12}\, x\, 100$$

∴ multiple credit would by 10 times.

$$Credit\ Multiples = \frac{Total\ Decivative\ Deposits}{Initial\ Excess\ Reserve}$$

$$\frac{\Delta D}{\Delta R} = \frac{90000}{9000} = 10$$

Multiple expansion of credit

Banks	Liabilities (In Rs.)	Cash Reserve (In Rs.)	Assets (Loans & Investments)
SBI	10,000	1,000	9,000
SBM	9,000	900	8,100
Canara Bank	8,100	810	7,290
Corporation Bank	7,290,	729	6,561
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Total	**1,00,000**	**10,000**	**90,000**

The final position of all the banks together will be

Particular	Liabilities	Particular	Assets
Deposit	Rs. 1,00,000	Cash Received	Rs. 10,000
		Loans & Investment	Rs. 90,000
Total	**Rs. 1,00,000**	**Total**	**Rs. 1,00,000**

Limitations of Credit Creation:

1. Availability of income yielding services
2. Business conditions
3. Banking habits of the people
4. Availability of cash
5. Leakages
6. Reserve Ratio
7. Monetary policy