INFLATION

This is the persistent increase in the general price level for goods and services in an economy in a given period of time.

Or; this is the continuous rise in the general price level for goods and services in an economy in a given period of time.

Inflation is associated with the following features;

i) Increase in prices must be persistent.

ii) Increase in prices must be for all goods and services.

iii) Prices must be increasing but not simply being high since this implies high cost of living.

Question

What is meant by the term inflation in an economy?

CAUSES OF INFLATION IN UGANDA

1. Excessive government expenditure. This increases the amount of money in circulation which increases in aggregate demand for goods and services hence rising prices leading to inflation.

2. Increased inflows of incomes from abroad. This arises from increased incomes by the nationals working abroad who bring in a lot of money which increases the purchasing power and demand for goods thereby leading to rising prices hence inflation.

3. Excessive issuance of the currency. This increases the amount of money in circulation which increases aggregate demand for goods and services hence rising prices and inflation.

Or; Uganda issues out a lot of money to finance its activities which increases people’s incomes and demand for goods and services hence rising prices and inflation.

4. Importation of goods from countries experiencing inflation. This is where expensive raw materials are imported which forces producers to increase prices for final goods and services thereby leading to cost-push inflation.

Or; expensive imports from countries experiencing inflation force importers to sell such goods locally at high prices hence inflation.

5. **Rising costs of production**. This is associated with the use of highly priced raw materials which makes final goods expensive on the local market leading to rising prices and inflation.

6. Greed for higher profits by traders. This is where traders keep on increasing prices for goods and services to raise more profits and this leads to inflation.

7. Speculation by business people or consumers. This is where traders create shortages of goods on the market through hoarding to sell them at high prices in future hence inflation.

Or; this is where traders anticipate increases in demand for goods in future and hide commodities in the current period to create artificial shortages thereby leading to increasing prices and inflation.

8. The unfavorable natural factors. This discourages production in agriculture which creates shortages and increases prices hence inflation.

Or; adverse natural conditions like long dry seasons, pests and disease reduce supply of agricultural goods which results into shortages and rising prices hence inflation.

9. Increased demand for a country's exports or excessive exportation of essential goods. This results into shortages in the domestic market hence rising prices and inflation.

10. Depreciation of the local currency. As a result, money loses value which increases the commodity prices hence inflation.

Or; this makes imports more expensive as it becomes costly to buy foreign currencies for import expenditure which increases prices leading to inflation.

11. Break down of infrastructure like roads. This makes distribution of goods and services costly due to increased cost of production forcing prices for final goods upwards hence inflation.

Or; this is because poor roads delays distribution of goods and services to markets leading to scarcity of goods hence rising prices and inflation.

12. Excessive credit creation. This makes loans cheaper which attracts many people to borrow money for consumption which increases demand and prices of output hence inflation.

Or; this increases the amount of money in circulation which increases demand for goods and services hence rising prices and inflation.

13. **Excessive borrowing from the central bank**. This is where government gets a lot of money from the central bank for local use which increases people's income and demand for goods hence rising prices and inflation.

14.The political instability. This destroys economic activities which creates shortages of goods and services hence rising prices and inflation.

Or; this limits distribution of goods and services which creates scarcity of goods and services hence rising prices and inflation.

Question

a) Explain the causes of inflation in an economy.

b) Account for persistent inflation in Uganda.

SUGGEST MEASURES THAT SHOULD BE TAKEN TO CONTROL INFLATION

The explanation must be in a suggestive form using; can, should, will, etc. This can be as follows;

1. Increase direct taxes. This reduces people's disposable incomes which limits demand for output hence a fall in prices thereby controlling inflation.

2. Reduce government expenditure. This reduces expenditure on provision of non-essential services which limits peoples incomes and demand hence a fall in prices which solves the problem.

3. Liberalize the economy. This removes restrictions on trade which make commodities more available on the market and forces prices downwards.

4. Provide tax incentives to investors. This lowers the cost of production which attracts production of more output which force prices downwards.

5. Develop infrastructure like roads. This eases distribution of goods and inputs and attracts production of more output which leads to a fall in prices hence inflation controlled.

6. Use restrictive monetary policy. This limits the amount of money in circulation which reduces demand for output hence a fall in prices and inflation controlled.

7. Control issuance of the currency. This limits the amount of money in circulation which reduces peoples disposable income which leads to a fall in demand and prices for output.

8. Modernize agriculture. This makes farming profitable which attracts farmers into production of more farm output which increases supply hence a fall in prices.

9. Privatize state enterprises. This enables government to sell off inefficient enterprises to private individuals to effectively and efficiently increase output which reduces prices.

10. Improve the political climate. This ensures peace and security which attracts economic activities which increases production of output and reduces prices hence inflation controlled.

11. Encourage importation from cheaper sources. Government should import raw materials from cheap sources so as to sell final goods and services at low prices which controls inflation.

12. Reduce government borrowing from the central bank. This reduces the amount of money in circulation limits demand for goods and services hence a fall in prices.

13. Reduce indirect taxes on essential goods. Government should reduce indirect taxes on essential goods and services so as to make them cheaper to consumers.

Question

a) Suggest measures that should be used to control inflation in an economy.

b) Suggest the policy measures that should be used to control inflation in your country.

POLICY MEASURES WHICH ARE BEING UNDERTAKEN TO CONTROL INFLATION IN UGANDA

Presentation strictly requires the use of present continuous tense (now tense) and the explanation should show how inflation is being controlled.

This is as follows;

1. Increasing direct taxes. Government is increasing direct taxes which are reducing people's incomes and demand for goods and services.

2. Reducing government expenditure. Government is reducing expenditure on provision of non-essential goods and services.

3. Liberalizing the economy. Government is removing restrictions on trade which is making more goods available on the market to reduce shortages.

4. Providing tax incentives to investors. Government is offering tax incentives to reduce the cost of production which is attracting more investment in production of more output hence low prices.

5. Developing infrastructure. Government is improving roads to reduce the cost of production which is attracting distribution of more goods in the country hence low prices.

6. Using restrictive monetary policy. Government is limiting on the amount of money in circulation which is reducing demand for goods and services.

7. Controlling issuance of the currency. Government is limiting the amount of money issued out from the central bank which is controlling demand for goods and services.

8. Modernizing agriculture. Government is encouraging farmers to use better methods of farming which is increasing output and lowering prices.

9. Privatizing state enterprises. Government is selling off inefficient enterprises to people who are organizing them to produce more output and reduce scarcity.

10. Improving the political climate. Government is ensuring peace and security which is attracting most people in production so as to increase output which is reducing prices.

11. Encouraging importation from cheaper sources. Government is importing raw materials from cheap sources so as to sell final gods and services at low prices.

12. Reducing government borrowing from the central bank. Government is reducing the amount of money got from the central bank for public use so as to limit demand for goods and services.

13. Reducing indirect taxes on essential goods. Government is reducing indirect taxes on essential goods and services so as to make them cheaper to consumers.

Question

Explain the measures being undertaken to control inflation in your country.

MEASURES THAT HAVE BEEN TAKEN TO CONTROL INFLATION

1. Increased direct taxes. Government has increased direct taxes which has reduced people's incomes and demand for goods and services.

2. Reduced government expenditure. Government has reduced expenditure on provision of non-essential goods and services.

3. Liberalized the economy. Government has removed restrictions on trade which has made more goods available on the market to reduce shortages.

4. Provided tax incentives to investors. Government has offered tax incentives to reduce the cost of production which has attracted more investment in production of more output.

5. Developed infrastructure. Government has improved roads to reduce the cost of production which has attracted distribution of more goods in the country.

6. Used restrictive monetary policy. Government has limited on the amount of money in circulation which has reduced demand for goods and services.

7. Controlled issuance of the currency. Government has limited the amount of money issued out from the central bank which has controlled demand for goods and services.

8. Modernized agriculture. Government has encouraged farmers to use better methods of farming which has increased output and lowered prices.

9. Privatized state enterprises. Government has sold off inefficient enterprises to people who have organized them to produce more output and this has reduced scarcity.

10. Improved the political climate. Government has ensured peace and security which has attracted most people in production so as to increase output and reduce prices.

11. Encouraged importation from cheaper sources. Government has imported raw materials from cheap sources so as to sell final gods and services at low prices.

12. Reduced government borrowing from the central bank. Government has reduced the amount of money got from the central bank for public use so as to limit demand for goods and services.

13. Reduced indirect taxes on essential goods. Government has reduced indirect taxes on essential goods and services so as to make them cheaper to consumers.

Question

Explain the policy measures that have been taken to control inflation in your country.

MERITS or POSITIVE IMPACT or EFFECTS or CONSEQUENCES or OUTCOMES OF INFLATION

Inflation is associated with both positive and negative effects in an economy. It should however, be noted that;

i) Positive effects are generated from mild or gradual or creeping inflation.
ii) Negative effects are generated from hyper or galloping inflation.

Creeping or gradual inflation is good to an economy because it enables producers to make more profits as they purchase inputs when prices are still low and sell their products when prices go up. This increases investment, production and employment.

Advantages are as follows;

1. **Inflation increases investment**. This is because prices for goods and services are high during this period which attracts investors.

Or; it is because mild inflation leads to a slight increase in profits due to a rise in commodity prices which stimulates production.

2. Inflation increases employment opportunities. This is due to expanded investment as producers expect to make more profits.

Or; this is due increased investment which arises from increased profits.

3. Inflation increases government revenue from taxation. This is due to the high profits generated by producers which are taxed by government.

Or; this is due to increased investment and production which are taxed by government during the period.

4. Inflation increases the level of exploitation of resources. This is due to high profits which attract more investors to make use of the available resources.

Or; this is as a result of increased investment and production during the time of inflation.

5. Inflation s**timulates economic growth**. This is due to increased investment during the time of inflation which increases production of more goods and services.

6. **Mild inflation encourages hard work in the economy.** This is because it forces people to work harder to meet the rising costs of living.

Or; people are stimulated to carry out economic activities in order to earn income to buy goods whose prices are slowly rising.

7. Inflation encourages creativity and innovation. This is because many people become creative with new businesses so as to share on the increasing profits.

Or; this is because during the period of rising prices people look for alternative means of survival and better ways of doing what they can do in order to survive.

8. Inflation encourages mobility of labour. This is because it forces people to look for better jobs and places of work so as to survive.

Or; due to rising cost of living, workers strive to find better paying jobs and they move from low paying jobs to better paying jobs for better survival.

9. Inflation helps an economy to recover from a depression. This is because it increases prices and incomes of people which boost AD.

Or; during the time of mild inflation there is a gradual increase in investment and output by producers which increases AD.

10. During inflation debtors or borrowers gain. This is because they pay back money of less value than what they borrowed.

Or; at the time of borrowing the value of money is still high and the borrower uses it to buy more goods and services from the market than at the time of paying back.

11. Inflation en**courages forced saving**. This is due to high incomes to wage earners that are taxed by government in form of NSSF or pension.

Question

a) Explain the merits of inflation in an economy.

b) Explain the advantages of mild inflation to your country.

DEMERITS or NEGATIVE EFFECTS or IMPACTS or CONSEQUENCES or IMPLICATIONS OF INFLATION

They are generated mainly from galloping or hyper inflation as follows;

1. Inflation discourages savings. This is because money loses value and people fear to save with banks during such a time.

Or; it discourages saving due to rapid loss of money value as it becomes of little value in future.

2. There is loss of confidence in the local currency. This is because the local money loses value and some people start using international currencies for transactions.

Or; it is because a high rate of inflation makes money lose its function as store of value and some people resort to barter trade.

3. People are strained in an attempt to cope with the rising cost of living. This is because people fore go leisure to look for more work so as to get money for survival.

4. Inflation worsens BOP position. This is because exports become expensive which reduces foreign exchange earnings abroad.

5. Inflation leads to production and consumption of low quality products. This is because producers increase output to get more profits without looking at the quality aspect.

6. Inflation increases income inequality. This is because business people make more profits compared to fixed income earners who become poorer.

Or; it is because during hyper inflation business people sell at high prices for higher profits compared to consumers who lose dearly.

7. Inflation makes government planning difficult. This is because it makes government funds for development so insufficient.

Or; it makes government to abandon some projects which strains government activities and economic growth.

8. Inflation discourages investment. This is because it makes the cost of production very high which discourages investment.

Or; this is because of the decline in the level of saving during the period of inflation.

9. Inflation leads to industrial unrest. This is because during the time of inflation, workers demand and strike for higher wages.

Or; this arises because trade unions begin to agitate for an increase in the wages for their members during periods of hyper inflation.

Or; it is due to trade union leaders that organize sit down strikes to make employers increase wages of their members and this creates industrial unrest.

10. Inflation discourages lending because creditors lose. This is because lenders get their money back with lower purchasing power than at the time of lending it.

11. Inflation reduces production. This is due of increased cost of production of which some firms close down.

12. Inflation leads to unemployment. This comes about as a result of the decline in the level of investment in the economy.

Or; it is due to high cost of production which forces some industries to close down production.

13. Government becomes unpopular. This is due to high prices for goods and services which annoy many people in the country.

Or; it is due to hyper inflation which leads to high cost of living where people's incomes are constant with high prices resulting into misery and discontent.

14. Inflation encourages illegal activities. This is due to some people who use illegal means to get incomes for the high cost of living.

Or; it encourages illegal activities like corruption and smuggling as people try to look for more incomes.

15. Inflation results into brain drain. This is due to highly educated and skilled people who lose hope in the country and moves to other countries where labour conditions are better.

Question

a) Examine the effects of inflation in an economy.

b) Examine the consequences of hyper inflation in an economy.

c) Assess the effects or impacts of inflation in your country.

d) Explain the effects of hyper inflation in your country.

CIRCUMSTANCES UNDER WHICH INFLATION MAY BE DESIRABLE IN AN ECONOMY

The points are extracted from the positive effects of inflation. Since the focus is put on the circumstances, the points must be stated or presented in a conditional tense so they begin with; when, in case, during the time of inflation, etc.

This is as follows;

1. **When inflation increases investment**. This is because prices for goods and services are high during this period which attracts investors.

Or; it is because mild inflation leads to a slight increase in profits for producers commodity prices are high which stimulates production.

2. When inflation increases employment opportunities. This is due to expended investment as producers expect to make more profits.

Or; this is due increased investment which arises from increased profits .

3. When inflation increase government revenue from taxation. This is due to the high profits generated by producers which are taxed by government.

Or; this is due to increased investment and production which are taxed by government during the period.

4. When inflation increases the level of exploitation of resources. This is due to high profits which attract more investors to make use of the available resources.

Or; this is as a result of increased investment and production during the time of inflation.

5. **In case inflation stimulates economic growth**. This is due to increased investment during the time of inflation which increases production of more goods and services.

6. **When inflation encourages hard work in the economy.** This is because it forces people to work harder to meet the rising costs of living.

Or; people are stimulated to carry out economic activities in order to earn income to buy goods whose prices are slowly rising.

7. When inflation encourages creativity and innovation. This is because many people become creative with new businesses so as to share on the increasing profits.

Or; this is because during the period of rising prices people look for alternative means of survival and better ways of doing what they can do in order to survive.

8. When inflation encourages mobility of labour. This is because it forces people to look for better jobs and places of work so as to survive.

Or; due to rising cost of living, workers strive to find better paying jobs and they move from low paying jobs to better paying jobs for better survival.

9. When inflation helps recovers an economy from a depression. This is because it increases prices and incomes of people which boost AD.

Or; during the time of mild inflation there is a gradual increase in investment and output by producers which increases AD.

10. When inflation makes debtors or borrowers gain. This is because they pay back money of less value than what they borrowed.

Or; at the time of borrowing the value of money is still high and the borrower uses it to buy more goods and services from the market than at the time of paying back.

11. **When inflation encourages forced saving**. This is due to high incomes to wage earners that are taxed by government in form of NSSF or pension.

Question

a) Under what circumstances may inflation be desirable in an economy?

b) Why may inflation be desirable in an economy?

c) Why may inflation be desirable in your country?

OBJECTIVES OF FIGHTING INFLATION IN AN ECONOMY

These are reasons given why government strives to keep or maintain a low rate of inflation in the county.

1. **To increase investment**. This is because prices for goods and services are high during this period which attracts investors.

Or; it is because mild inflation leads to a slight increase in profits for producers' commodity prices are high which stimulates production.

2. To increase employment opportunities. This is due to expanded investment as producers expect to make more profits.

Or; this is due increased investment which arises from increased profits.

3. To increase government revenue from taxation. This is due to the high profits generated by producers which are taxed by government.

Or; this is due to increased investment and production which are taxed by government during the period.

4. To increase the level of exploitation of resources. This is due to high profits which attract more investors to make use of the available resources.

Or; this is as a result of increased investment and production during the time of inflation.

5. **To stimulate economic growth**. This is due to increased investment during the time of inflation which increases production of more goods and services.

6. **To encourage hard work in the economy.** This is because it forces people to work harder to meet the rising costs of living.

Or; people are stimulated to carry out economic activities in order to earn income to buy goods whose prices are slowly rising.

7. To encourage creativity and innovation. This is because many people become creative with new businesses so as to share on the increasing profits.

Or; this is because during the period of rising prices people look for alternative means of survival and better ways of doing what they can do in order to survive.

8. To encourage mobility of labour. This is because it forces people to look for better jobs and places of work so as to survive.

Or; due to rising cost of living, workers strive to find better paying jobs and they move from low paying jobs to better paying jobs for better survival.

9. To recover an economy from a depression. This is because it increases prices and incomes of people which boost AD.

Or; during the time of mild inflation there is a gradual increase in investment and output by producers which increases AD.

10. To enable debtors or borrowers gain. This is because they pay back money of less value than what they borrowed.

Or; at the time of borrowing the value of money is still high and the borrower uses it to buy more goods and services from the market.

11. **To encourage forced saving**. This is due to high incomes to wage earners that are taxed by government in form of NSSF or pension.

Question

a) Mention any four objectives of combating inflation in an economy.

b) State any four objectives of fighting inflation in your country.

RELATIONSHIP BETWEEN INFLATION AND UNEMPLOYMENT

1. High rate of inflation discourages investment due to high cost of production which forces firms to close down hence unemployment.

2. High levels of unemployment leads to low levels of production causing shortage of goods and services hence high prices and inflation.

3. High levels of inflation lower AD which discourages production leading to closure of firms hence unemployment.

4. High levels of inflation force workers to demand for high wages which raises the cost of production and force producers to resort to capital intensive methods of production leading to technological unemployment.

5. Fighting inflation through measures such as restrictive monetary policy and high taxes on people's incomes, limit demand for goods and services hence affecting production leading to unemployment.

6. Fighting unemployment through methods like expansionary monetary policy and provision of subsidies to producers to increase the amount of money in circulation which results into excessive demand leading to demand pull inflation.

7. Both inflation and unemployment have similar effects such as income inequality, poor standard of living and political unrests.

MEASUREMENT OF INFLATION

Rate of inflation or Price level: This is the average of prices for all goods and services in the economy.

The rate of inflation is measured by use of price indices. The usual procedure of computing price indices is used.

If the computed price index is 108, then the rate of inflation is;

Rate of inflation = $\frac{Price\ index - Base\ year\ index}{Base\ year\ index}$ x100

Rate of inflation = $\frac{108-100}{100}$ x 100

= 8 %

If the computed price index is 92, the rate of inflation is;

Rate of inflation = $\frac{Price\ index - Base\ year\ index}{Base\ year\ index}$ x 100

= $\frac{92-100}{100}$ x 100

= -8 % (Negative inflation)

This implies that the general price level for goods and services has fallen too low. The negative coefficient reflects what is referred to as deflation.

Deflation: This is the persistent decrease in the general price level for goods and services in an economy in a given period of time.

Question

a) What is meant by the term deflation in an economy?

b) Give two merits of deflation

1. Encourages saving since the value for saving increases.
2. Value of the currency gains in real terms.
3. Corrects balance of payment deficits since exports gain value than imports.
4. Implementation of government plans becomes easy.
5. Reduces industrial unrests as real incomes increase.
6. Leads to reduced cost of production

c) Mention two demerits of deflation

1. Low taxes due to limited economic activities.
2. Fall in aggregate demand due to low incomes.
3. High government expenditure to generate production.
4. Leads to unemployment due to reduced investment.
5. Debtors lose because they pay more in real terms.

STATE OF INFLATION

This is the speed at which the general price level of goods and services is increasing. The state of inflation involves the following;

Mild or Gradual or Creeping inflation or one digit inflation. This is one where the persistent increase in the general price level proceeds at a very slow rate usually not exceeding 10 % per annum.

This state of inflation is desirable in an economy because it encourages investment, employment and resource allocation.

Question

a) Distinguish between creeping inflation and galloping inflation.

b) Mention two positive effects of creeping inflation.

c) Mention two merits of creeping inflation. These are drawn from the merits of inflation for example;

1. Encourages hard work.
2. Encourages saving.
3. Promotes creativity and innovativeness.
4. Encourages production of more goods and services.

Hyper or run away or galloping inflation: This is a type of inflation where the general price level increases at a very high rate usually over 20 %.

Galloping inflation always manifests itself in form of double or triple digit inflation.

This state of inflation is undesirable in an economy because it discourages investment, production which leads to unemployment and balance of payment problems. This type of inflation greatly reduces the value of money within a short period of time.

Question

a) Distinguish between suppressed inflation and hyper inflation in an economy.

b) Mention two effects of hyper inflation in an economy.

1. Discourages saving in an economy.
2. Leads to loss of confidence in the national currency.
3. Worsen the balance of payment position in the country.
4. Encourage illegal activities.

Question

a) Distinguish between suppressed inflation and hyper inflation.

b) Mention two effects of hyper inflation in an economy.

THEORIES OF INFLATION

Demand-pull theory: It states that inflation in an economy is caused by excessive AD for goods and services over AS at full employment of resources.

AD is not matched with AS which increases prices for goods and services hence inflation.

Cost-push theory: It states that inflation is due to increase in the cost of production.

As a result, producers increase commodity prices so as to maintain their profit margins hence inflation.

Structuralist theory: It states that inflation in an economy comes about as a result of supply rigidities in the economy.

Or; inflation is due to structural break down in an economy. These include political unrest & natural factors which hinder production of goods and services which results into shortages hence high prices and inflation.

Monetarist theory: It states that inflation in an economy is caused by an increase in money supply.

Excessive increases in money supply results into increased amount of money in circulation against few goods and services which increases commodity prices hence inflation.

Speculative theory: It states that inflation in an economy is due to speculative tendencies by both producers and consumers.

If producers anticipate prices to rise in the near future hoard goods in the current period resulting into shortages and high prices.

Or; if consumers or buyers anticipate prices to rise in the near future increase demand in the current period which force producers to increase prices hence inflation.

Question

Mention four theories of inflation in an economy.

TYPES AND CAUSES OF INFLATION

DEMAND PULL INFLATION

This is a type of inflation as a result of excessive AD for goods and services over AS in an economy.

This results into too much money chasing fewer goods and services in an economy because of increased purchasing power.

Or; it arises out of excess AD over AS at full employment of resources.

CAUSES OF DEMAND PULL INFLATION

It is mainly caused by;

1. Excessive printing and issuance of the currency by the central bank. This increases the amount of money in circulation which increases people's demand for goods and services hence rising prices.

2. Excessive government expenditure. This increases the amount of money in circulation which raises people's demand for goods and services hence inflation.

3. Excessive increase in salaries and wages. This increases people's disposable income and demand for goods and services hence high prices and demand pull inflation.

4. Excessive inflows of incomes from abroad. This increases people's disposable income and eventually high AD for goods and services hence high prices.

5. Increased demand for exports especially by neighboring countries. This creates scarcity of essential goods and services in the domestic market which increase their prices.

6. Excessive creation of credit by commercial banks. This increases the amount of money in circulation which increases AD for goods and services hence high prices.

MEASURES FOR DEMAND PULL INFLATION

This can be controlled by measures that reduce aggregate demand in addition to other measures as follows;

1. Increasing direct taxes. This reduces people's disposable incomes and AD hence low prices.

2. Use of restrictive monetary policy. This is reduces the amount of money in circulation and people's purchasing power hence fall in demand and prices.

3. Reduction in government expenditure. This reduces government spending to particular sectors which also limit money supply and demand hence low prices.

4. Wage control measures. This keeps people's salaries and incomes at low levels so as to reduce demand and prices.

5. Use of price controls. This keeps prices from increasing beyond certain limits.

Question

a) Distinguish between demand pull inflation and cost push inflation.

b) Mention two causes of demand pull inflation in your country.

c) Mention two merits of demand pull inflation.

1. Stimulates effort and hard work among producers which increase output.
2. Helps to monetize the economy which reduces the level of subsistence.
3. More employment opportunities are created.
4. Saving is promoted in the economy especially among producers which boosts investment.
5. Debtors gain since they pay back the loans in inflated terms.
6. Encourages competition among producers due to increased demand for goods and services.

d) Outline two demerits of demand pull inflation.

1. Creditors lose since they receive back their money lent out with much lower value than before.
2. The value of money falls due to increasing prices.
3. The government in power becomes unpopular.
4. Government planning becomes unpopular.

1. Discourages exportation of scarce goods.

COST-PUSH INFLATION

This is a type of inflation brought about by rising costs of production.

Or; it is a type of inflation caused by an increase in the cost of production.

Because of the increase in the cost of production, producers increase prices of commodities in order to maintain or increase the level of profits.

Or; as the cost of production increases, producers also increase prices of commodities in order to recover the costs of purchasing inputs.

CAUSES OF COST PUSH INFLATION

Cost push inflation is caused mainly by;

1. Increase in wages. This increases the cost of production as more wages are given to workers.

2. Cost push inflation usually occur in form of inflationary spiral. This is where a persistent increase prices force workers to demand for higher wages which increases the cost of production hence high prices.

3. Rising prices raw materials used as inputs in production. This at times is due to a rise in indirect taxes on those raw materials.

4. Increase in the rate of taxation on producers. This increases the cost of production and prices of final goods and services as more taxes are paid.

5. Increase in transport costs. This is due to rising prices of fuel which causes an increase in the cost of transporting raw materials hence high cost of production and high prices for goods.

Question

a) Explain the causes of cost push inflation in an economy.

b) To what extent are inflationary tendencies in your country as a result of rising costs of production?

MEASURES FOR COST PUSH INFLATION

This can be controlled by measures that reduce the cost of production for goods and services as follows;

1. Subsidize producers. This is by providing subsidies on factor inputs like electricity; and fuel to reduce the cost of production and lower prices.

2. Extend tax concessions to producers. This is by providing tax holidays, and other tax reductions so as to reduce the cost of production and lower prices.

3. Wage control measures to prevent wages from increasing. This is by use of either wage freeze which keeps wages at the existing levels for a specified period of time so as to check inflation or; wage restraint where government encourages trade unions and employers to keep wages at the existing levels so as to check on inflation.

4. Reduce interest rates on loans advanced by commercial banks. This helps producers to acquire cheap loans so as to produce more output at lower costs or prices.

5. Reduce charges on rent. This helps to reduce the producer's expenditure on rent hence lowering the costs of production and prices.

Question

a) Mention any four measures for cost push inflation in an economy.

b) Outline any two solutions to cost push inflation in your country.

FORMS OF COST PUSH INFLATION

Price-wage inflation or inflation spiral: This is where an increase in prices force labour to demand for high wages which increases the cost of production and force producers to increase prices of goods.

Wage-wage inflation: This is due to comparing wages across similar occupations and workers. This increases the cost of production and forces producers to increase prices for goods and services.

Wage-price inflation: This arises from the increase in wages which increases the cost of production and force producers to increase prices further leading to inflation.

Question

a) Mention three forms of cost push inflation in an economy.

b) Outline any four forms of cost push inflation in your country.

STRUCTURAL or BOTTLENECK or SCARCITY INFLATION

This is a type of inflation brought about by structural rigidities in an economy.

Or; it is the persistent increase in the general price level due to supply rigidities.

Supply rigidities hinder smooth production of goods and services which brings about shortages or scarcity of goods and services in the market hence resulting into rising prices leading to structural inflation.

CAUSES OF STRUCTURAL INFLATION

This is mainly caused by the following factors;

1. Political instability. This hinders smooth production of goods and services which results into shortages and rising prices in the market.

2. Unfavorable natural factors. This limits production in agriculture resulting into shortages and rising prices for goods and services in the market.

3. Break down of infrastructure. This makes transportation of goods and services costly which force producers to increase prices for goods.

4. Scarcity of raw materials. This makes it difficult for producers to get raw materials' hence scarcity and high prices.

5. Break down of key industry hence scarcity of commodities. This is due to breakdown of major producing industry which results into scarcity of goods and high prices.

6. Speculation by businesspeople who hoard commodities in the current period. This is due to expectation of price increases in future which leads to scarcity and high prices for good.

Question

a) State any two causes of structural inflation in an economy.

b) Mention any two causes on structural inflation in your country.

MEASURES OF STRUCTURAL INFLATION

This can be controlled by policies which increase production of goods and services in the economy after removing bottlenecks that hinder production.

This is as follows;

1. Improve the country's infrastructure. This is by improving the major and feeder roads which facilitates easier movement of goods to markets to avoid shortages.

2. Reduce dependence on nature. This is by modern farming methods which reduces the risk of loss in the sector hence more output.

3. Ensure political stability. This attracts investment which increases production of goods and services.

4. Import raw material from cheaper sources. This enables producers to get raw materials cheaply hence increasing output.

5. Liberalize the economy to increase output. This increases the number of producers in the economy hence increasing output.

Question

a) What is meant by the term structural inflation?

b) Mention three measures for structural inflation in an economy.

c) State any four solutions to structural inflation in your country.

Imported inflation: This is a type of inflation brought about by importation of commodities from countries experiencing inflation.

Question

a) What is meant by the term imported inflation.

b) Mention three measures for controlling imported inflation.

1. Use of trade restrictions like trade embargo on highly priced imports.

2. Establish import substitution industries to produce formally imported goods.

3. Give subsidies to producers who import raw materials to enable them produce at low costs.

4. Encourage importation from cheaper sources.

c) State two causes of imported inflation.

1. Importation of highly priced consumer goods.
2. Importation of highly priced raw materials.
3. Increased cost of shipping.
4. Increased taxes on imports.
5. Continuous depreciation of the local currency.

Monetary inflation: This is one due to increase in the amount of money in circulation in the economy.

According Irving Fisher, the increase in the amount of money in circulation (M) leads to arise in the general price level (P) for goods and services assuming the level of transaction (T) and the velocity of circulation (V) are held constant.

$$P = \frac{MV}{T}$$

Profits push inflation: This is one due to greed for high profits by producers which force them to increase commodity prices for goods and services in the economy.

Speculative or expectation inflation: This is a type of inflation brought about by speculation either by buyers or sellers in the market.

If sellers anticipate prices to rise in the near future, it may result into hoarding and shortages of commodities and consequently, increase in prices.

In the same way, if consumers or buyers expect prices to rise in the near future, they might purchase goods in large quantities in the current period which force producers to increase prices.

CONCEPTS UNDER INFLATION

Stag-flation: This is the existence of both high levels of inflation and high levels of unemployment in the economy at a given period of time.

Question

a) Give two features of stagflation.

1. Stagnation such as low incomes, low production, low prices and unemployment.
2. Inflationary recession where unemployment exists alongside high commodity prices.
3. Excess capacity in industries.

b) Give two effects of stagflation.

1. Leads to income inequality in the economy.
2. Decline in standard of living.
3. Loss of confidence in the national currency.
4. High cost of borrowing due to high interest rate.

5. High rates of brain drain.
6. Low saving and investment.
7. High dependence burdens.

c) Outline two measures for stagflation.

1. Increase government expenditure to boost production.
2. Reduce taxes encourage investment.
3. Reduce interest rate on capital.
4. Reduce the cost of production to increase output.

Reflation: This is the deliberate government policy to increase commodity prices so as to recover the economy from a depression.

Suppressed inflation: This is a type of inflation where AD is greater than AS but when the increases in prices is being checked by measures like price controls and rationing.

Question

a) Mention two instruments of reflationary policy.

1. Encourage exports.
2. Increase government expenditure.
3. Reduce taxes.
4. Increase government expenditure or subsidies.
5. Use of expansionary monetary policy.
6. Increase wages.

b) Distinguish between deflation and reflation.

c) Mention two instruments of reflationary policy in an economy.

Headline inflation: This is a type of inflation which takes into account increases in prices of all commodities in the economy. These include; manufactured goods and food stuffs.

Or; its inflation based on the relative changes in prices of commodities including food products.

Underlying inflation: This is one which takes into account increases in prices of all commodities in an economy except food items.

Or; its inflation based on increases in prices of commodities not including food crops.

Question

Distinguish between underlying inflation and headline inflation.

Hidden inflation: This is where inflation is occurring but the normal indicators does not reveal it.

Open inflation: This is one where the markets for goods and factors operate freely setting prices for goods and factors without government interference.

Disinflation: This is a deliberate government policy to control inflation so as to maintain the money value through use of measures such as price controls and high taxes.

Strato-inflation: This is one which ranges from 10^{th} percent to 100^{th} percent in the economy in a given period of time.