Book Review


Traditionally inflation has been seen as a purely economic problem. In recent years studies have emphasized that the present-day inflation is more than an economic problem. It has deep roots in the political and social systems which have strong connections with the economic mechanism of society. Inflation is analyzed and conceptualized as a problem in political economy. It is a worldwide phenomenon but it has become most pertinent in the case of developing countries where the socio-economic fabric of the society is far removed from that of the developed countries on whose experience the prevalent economic theories of inflation are based. As such when the theories completely divorced from reality are applied in the developing economies they aggravate the situation further. The book under review is free from this blemish as it examines the problem of inflation with reference to the socio-economic and political set-up of the developing countries in general and to the Indian situation in particular.

The book, consisting of 47 chapters and divided into six parts, examines the nature, origin, causes and consequences of inflation from the point of view of developing economies. The approach is both theoretical and empirical. The book is also policy-relevant as it contains an extensive discussion of different policy options aimed at reducing inflationary pressures. In the first part, the author provides an overview of inflationary trends in the world economy. Empirical evidence on the inflationary experience of industrial countries under the pure gold standard and the gold exchange standard shows that under the former system world price level had moved in direct proportion to the ratio of gold stock which had increased very slowly at an annual average rate of 3 percent. During the post-World War period under the gold exchange standard sterling and dollar were no longer the reserve currencies and had given way to fiat money. During this era, the world price level moved in direct proportion to world money supply which had increased very rapidly.

The chapter on Types and Sources of Inflation confirms the author's contention that general theories of inflation are not always relevant in the case of developing countries. The author draws careful distinctions between different types of
Inflations in economic literature — export boom inflation, import price hike inflation, key currency inflation, Schumpeterian credit inflation, profit inflation, wage-push and demand-pull inflation — and shows that under the economic, social and political systems of India the external factors do not play a major role in explaining inflation. Excessive credit-creation by the banking system to finance private and government sectors' development and non-development expenditures and windfall profits — not as a result of innovation and increased productivity as argued by Western authors but due to hoarding of commodities, trading in real estate and gold and widespread smuggling — have played a major role in accelerating inflation in India. Demand-pull inflation is attributed more to these factors than to an increase in autonomous expenditures. In developing economies since the proportion of unionized labour is quite low, demand for wage rises is rather defensive. The labour tries to keep its real wages undiminished while the cost of living keeps rising. This is quite a different type of wage-push inflation from the one found in economic literature. Inflation in the developing economies is thus determined by factors that are peculiar to those economies.

Part II makes a detailed presentation of different theories regarding determination of price level. These theories are critically examined with reference to Indian conditions. The Keynesian theory of price behaviour is shown not to hold under Indian conditions. A comprehensive discussion on Keynesian versus monetarist approach shows that this debate is not pertinent to developing countries. These models and theories of inflation have been formed on the experience of industrial countries which certainly have no relevance to the poor economies. The Real Cash Balance theory, tested empirically, does not withstand the Indian data. Having considered all the theories of inflation inclusive of structuralist models, the author concludes that the conditions of developing economies are best explained by monetarist-inventorist approach which takes into account both monetary hoarding and commodity hoarding.

Having established that the basic causes of inflation in the developed and the developing countries are quite different and that the theories based on the experiences of the former do not hold for the latter, the author shifts to a discussion of the consequences of inflation. Part III examines the relation of inflation to production and production structure, unaccounted incomes, distribution, savings, trade-off between inflation and unemployment, growth models, interest rates, fiscal situation, deficit financing, trade and exchange rates, and welfare economics. Growth, unemployment and deficit financing and their interrelationships with inflation are discussed in the context of both developed and underdeveloped countries. The discussion on the consequences of inflation is the most crucial part of the book in that it helps to understand why inflation in poor countries cannot be used as an engine of growth as was the case in many developed countries. The chapters on unaccounted incomes, fiscal situation and deficit financing bring out the peculiar conditions prevailing in poor countries that explain the different outcomes obtained in these economies from inflationary episodes. The governments despite the control over the issue of currency are unable to control money supply. They have to resort to deficit financing and excess credit creation which do not always flow into production channels as the public have vast avenues of tax-evasion, hoarding, black-marketing and dual accounts. Demands for wage increases are also not linked with productivity increases. These economies are caught in a vicious circle. The money stocks created in excess of the level required to support the production of goods and services, defined by the author as "stockless money", leads only to persistent inflation which in turn has no beneficial effects on the growth of the economies. The persistent inflation, caused by the stockless money, is characterised by the author as "growthless inflation".

Discussion on consequences of inflation is followed by a detailed analysis of policy options to combat inflation in Part IV. In the light of the conditions prevailing in the poor economies the control of inflation through cuts in capital budgets on the part of the government is found by the author to be the most suitable course of action. Since the government is aware of the seriousness of inflation and is not a party to looking forward to gains from rising prices, a cut in its own expenditures, which must be across the board, would be easy to implement without much controversy. The control of perpetual inflation, however, requires a different policy action by the government. The author argues for a statutory restriction on the rate of growth of money supply by restricting the ratio of public debt to national income or to public expenditures.

Part V of the book provides the readers with a very interesting discussion of comparative experience of developed and developing countries on connection between inflation and growth. With the help of data it is shown that in the developed countries there is a positive relationship between growth rate of money and domestic product and between stockless money and rate of inflation. However, in the developing countries only the latter relationship holds. It is shown empirically that compared to the gold standard money supply had increased very fast under the reserve currency system and had resulted in high rates of inflation. Carrying the line of argument further, it is shown with the help of statistics that the replacement of gold standard with the reserve currency system had resulted in world inflation which had adversely affected the poor countries. Among the various solutions to control inflation and to reduce inequalities between the developed and developing countries, the author argues for a return to pure gold standard or to a modified gold standard.

Part VI discusses issues of the inevitability of world slump and/or a continuing global inflation. Possible solutions to the global inflation are also presented.
The book contains a comprehensive survey of the causes, sources and consequences of inflation in developing countries in general and in India in particular. The author shows clearly that whatever the merits of inflation in the developed countries, it has severe adverse effects both in the long run and in the short run in the cases of poor developing countries, and that inflation has to be treated in the light of socio-economic and political framework of these economies rather than through an application of the traditional theories. The book is both useful and absorbing and must be read by all those who are interested in understanding and overcoming the problem of inflation.

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