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What Are The Causes Of Inflation? Can Government Control It? Discuss Which Economic Policies Are Appropriate For The Control Of Inflation.

Inflation is a sustained rise in the average prices of goods within an economy, it can also be seen as a change in the purchasing power of money. Inflation can normally be divided into two types cost-push and demand-pull. Cost-push happens when prices are pulled up by rising costs, demand-pull happens when demand outstrips supply and prices will therefore have to rise to accommodate this.

Monetarists argue that inflation is caused increases in the money supply, the total amount of money circulating in the economy at one time. This is as the believe that any increase in the money supply which is not in line with the growth in output of the economy will lead to inflation. If the money supply was increased in the short-run then consumer spending would increase but the output of the producers would not be able to expand, as quickly, so there would be an increase in price to curb this demand. They believe that the money supply should be kept in line with the rate of growth of the output.

Another theory for the cause of inflation is the demand-pull theory, this is a theory, which attributes inflation to high levels of demand in the economy. It will come about when there is excessive spending, this will then lead to a increase in the quantity of goods demanded which can not be met by the current level of supply, therefore prices must rise in order to curb this demand but this type of inflation may have many causes. It could be due to a rise in consumer spending or firms investing in more machinery, increase in government expenditure or even more exports being brought from abroad.

Increasing costs may also lead to inflation, rising costs, cost-push inflation. This will occur when a firm is experiencing a rise in the cost of their factors of production this will then force them to raise their prices for them to remain in business. These rising cost could be attributed to rises in the workers salaries, workers and unions push for and receive an increase in their wages. Tax increase, indirect taxes can increase the cost of production and then force the firm to raise their prices. A profit push by a firm to raise profit levels due to pressure from shareholders can increase production costs if monopoly power is used. The price of imported goods can lead directly to inflation if these rise and it will be more direct if it is imported finished goods as it will add to the general level of prices. Another lees common cause is if the natural resources from shareholders can increase production costs if monopoly power is used. The price of imported goods can lead directly to inflation if these rise and it will be more direct if it is imported finished goods as it will add to the general level of prices. Another less common cause is if the major natural resources of a country are running down (i.e. north sea oil, decline is fishing stocks.) Perhaps another cause of inflation could be uncertainty and lack of investment. Inflation causes uncertainty amongst the business community, especially when it is fluctuating. If it's difficult for a firm to predict their costs and revenues they may decide not to invest, therefore this will reduce the rate of economic growth. The policies, which are designed to reduce inflation, may actually reduce economic growth, especially in the short-run.

On of the most important tasks of any government are to control inflation, this could be done in a variety of ways. One way is to adopt a monetary policy; this is, as a monetary policy will accommodate the shock when a change in price induces the

government to provide a matching change in the nominal money supply to avoid any changes in the short-run money supply. As high interest rates will equal high inflation.
Another way the government could increase it's public spending and finance it through issuing public bonds but this can only be a short term solution as the bonds will have to be paid back though the government spending will fuel further spending in the economy.
Though the government could use monetary policy, by controlling the amount of money flowing around the economy this is a tool which can be used to tackle inflation and any balance payment problems. Controlling interest rates to control the borrowing in the economy i.e. reduce the money in circulation and the value of the currency higher interest rates will attract overseas investment to put money into banks for5cing up the value.
Other ways in which the government could control is: - strict control of the credit financial institutions
Bank of England sets interest rates
Bank of England controls banks assets

Fiscal policy
Aims to manage the levels of spending in the economy
Changes in government spending in accordance with the economy i.e. to curb inflation, government spending. Or it could be used to slow the economy down
Changes in direct taxation to encourage people to spend in accordance with the need of the economy, these are taxes that are added to goods i.e. V.A.T this means that the price of the goods are raised and will discourage spending, it is also another way of the government to raise revenue in order to finance public spending plans.

Supply side policies, these are policies, which enable the producers to operate effectively. Increase in competition and reward for hard work and innovation
Reducing income or corporation tax to encourage entrepreurs and employees to be more efficient by allowing them to keep more of their income or company profit.
Cutting state benefit in order to encourage the unemployed o return to work.
Privatising nationalised industries to open them up to competition from other businesses.
Supporting firms that provide training to create a more efficient workforce
Control of trade unions as they may prevent wages from being flexible
Removal of restrictions to employment such as maximum number of working hours per week
Reducing the national insurance contributions of employers in order to reduce the cost of taking on new employees
Exchange rate policy, this policy will affect the costs of imports and exports so therefore will have a knock on effect on inflation.
Income policy is the process of imposing limits on pay and price increases maybe a pay freeze on public sector workers pay.