

Of Inflation, GDP and Government

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Inflation can make the government and it can break it too. Inflation can be good, it can be bad. In other words, inflation is like our next door neighbor who gets polite sometimes and irritates other times. The importance of this phenomenon can be judged by the fact that it is one of the most used words in print and electronic media.

Now what is inflation? Well for non economists, it is like the greatest evil on the planet. It eats your salaries, cuts your spending, decreases your savings, and makes you redo your budget every month. It is even greater peril for the government who can ignore it, but can't do away with it. Inflation has been portrayed as the villain whose job is just to make peoples' lives even more miserable. Yet, only an economist student can tell the true nature of inflation. And here comes the surprise, inflation is not always a villain!

Inflation is inevitable when the economy is expanding. And it increases by faster amounts as the economy approaches full capacity. Gross Domestic Product(GDP) measures the output in an economy. And as GDP pushes up, peoples' incomes increase, thereby increasing aggregate demand and hence prices push up. So if an economy is trying to expand, inflation would come along. Yet, it must not be too large; otherwise the benefits of increased production would be marred by reduced purchasing capacity due to inflation.

In an economy like India, government plays a very important role in deciding the fate of the economy. It can stimulate the economy in many ways. What is happening in India is a result of increased production. On one hand, while GDP is looking healthy at 8.5%, inflation reached as high as 11.6% in June 2010.

It becomes very important for the government to look at the effects of inflation before making any decision about the GDP growth. There exists a strong relationship between the government, GDP and inflation.

Even though prices have shot up in India, there is still a positive side to it, increased growth.