Inflation is a global phenomenon. There is no country in the capitalist world that is not hit or affected by its spectre. In general parlance, ‘Inflation’ is a sustained increase in the general price level of goods and services in an economy over a period of time. It represents a decrease in the purchasing power of each unit of the currency and leads its spenders onto affording fewer goods and services. Inflation is measured through ‘inflation rate’, which signifies the annual percentage change in the consumer price index of the country.

In world economy, Australia and India are forces to be reckoned with. While India is the world's seventh-largest country in terms of nominal GDP, Australia is known as one of the world’s largest mixed market economies with a GDP of AUD$1.62 trillion, till the year 2015. Driven by mutual interests and ties, the two countries have had a total bilateral trade worth US$18.7 billion, as of 2010, which is expected to rise to US$40 billion by end of 2016. India and Australia generally have a warm relationship, with shared political, economic, security, lingual and sporting ties.

However, despite such a strong stature, both nations have been unable to escape the claws of inflation. For Australia, inflation has typically been 2–3% and the base interest rate 5–6%. From the mid-1950’s to late 1960s, inflation was relatively low. Owing to high oil prices, wage increase and various policy reforms, the Australian economy suffered a sharp inflationary pressure from the early 1970s to 1980s. By 1990s, the rates slowed down and Australia greeted the 2000s with a stable inflationary rate of around 3%. Apart from the only significant change witnessed by the country in its inflationary rates during the taxation reforms of the early 2000s, Australia has enjoyed a relatively stable inflationary ground.

On the other hand, the Indian economy has been caught in a high-inflation trap. At present, the annualised inflation rate in India is 3.78% as of August 2015, as per the Indian Ministry of Statistics and Programme Implementation. During the 1990s and early 2000s, inflation in India exhibited a relatively better standing than other emerging economies. After being low for a decade, it rose rapidly to even touch 10-11 percent in the year 2008 and continued to stay high. Prices of necessaries, especially food items, had almost doubled in the year 2013, as compared to 2007.

The following charts elucidates the trend in inflation in Australia and India respectively from the data collected in the past 10 years:

A higher rate distorts and stunts the free flow of demand and supply in the market. High inflation also leads to a wage-price inflationary spiral, uneven and inconsistent distribution of income, increase in the rate of unemployment, international competitiveness, and a severe impact upon the exchange rate. Inflation is one of the major constraints for economic growth, and has a significant and severe impact on both Australia and India alike.

Factors Influencing Inflation

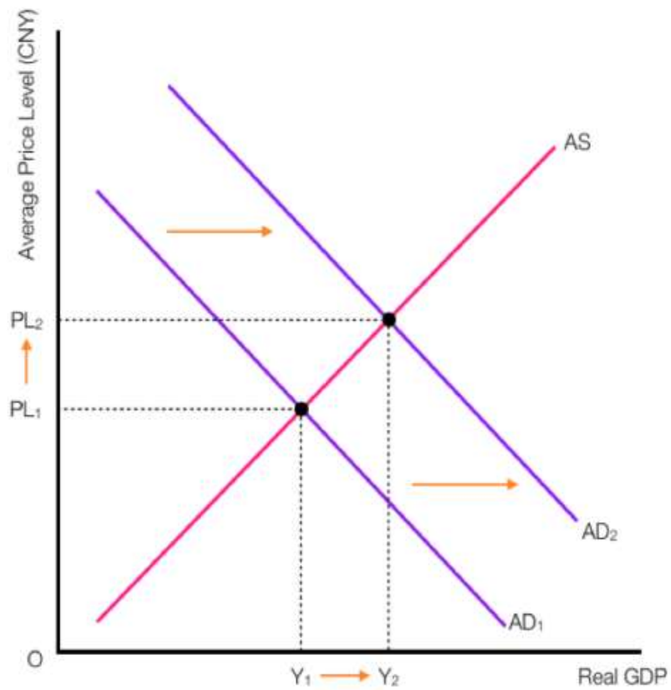
There are various factors in Australia and India that influence their inflationary rates. While some factors are common between the two, other causes are geographically centric and domestically exclusive. At the core, inflation is usually caused by demand-supply gap. World economies, however, mostly face situations of Demand-Pull Inflation and Cost-Pull Inflation. These theories, as propounded under the Keynesian economics, have been elucidated with reference to Australia and India.

I. Causes of Inflation in Australia

The Australian inflationary rate is affected by two main types of factors, which are:

1. *Aggregate Demand Factors causing Demand Inflation:*

An increase in aggregate demand, or any demand-side factors, leads to a surge in the number of consumers chasing a limited number of Australian-made goods and services. In simpler words, the Aggregate Demand (AD) will exceed the Aggregate Supply (AS) of the goods and services in the Australian economy. Thus, when national production fails to meet the national spending, the consumers will bid against each other to acquire the limited supply of goods, which will lead to an increase in general price level of goods and services. The demand curve is forced to shift to the right from AD_1 to AD_2 while the supply curve remains stationary at AS, causing pressure upon price of goods to increase from PL_1 to PL_2.



Such surge in prices caused solely by demand factors is known as demand inflation. Such a situation is commonly referred to as a ‘boom’. Australia has often experienced such bursts of demand inflation, for instance, the Korean War boom (early 1950s), the late 1980s, between 2005 and mid-2008 and to a lesser extent, during 2010–11. A leading example in Australia for demand-pull inflation has been its real estate market. In the early 2000s, there was a rapid increase in the demand for houses, which led to more consumers chasing a limited supply of houses in a short period of time.

Illustrations of the aforementioned demand-side factors that cause demand inflation are:

- A rapid increase in Australian household income that raises private consumption boosts the demand for products.
- Better economic conditions of the trading partners of Australia, which enables them to purchase more of Australian-made products.
- An expansionary budgetary scheme (for instance, a budget deficit) that provides for lower tax rates or higher spending by the government leads to an increase in the overall expenditure, causing an inflationary pull.

- Lower interest rates on credit which stimulates the amount of borrowings by households and business. Such borrowings are generally used to finance private consumption and investment expenditure, causing an increase in the aggregate demand.
- Reduction in the amount of savings by households and indulging in unusual spending. Similar notion is adopted in case of businesses when they expand the scale of their organization and increase their investment. Such activities on a mass scale increases the flow of money in the economy, leading to higher demand for goods.

To curb demand inflation, it is pertinent to weaken the demand-side conditions. In Australia, it was done by way of lowering the growth in spending in the year 2008-09, and by forcing the economy to go into recession in 2008–09 or 2010–11. The sudden drop in the rate of expenditure leads to overproduction and an increase in the stock of unsold commodities. To clear this stock, producers lower the prices of goods and services to pull the demand up to the supply. The lowering of prices, thus, reduces demand inflation.

2. *Aggregate Supply Factors causing Cost Inflation:*

Cost inflation occurs when rising production costs cause firms to put up their final selling prices in order to protect their profit margins. Cost inflation can occur in any economic condition, even when there is high unemployment. The most common supply-side factors that cause rising production costs or cost inflation are:

- An increase in minimum wages of workers, for example in the year 2013 and 2014, there is a pressure on the production cost of goods and services, which accelerates inflation.
- Low labour productivity or production efficiency (either by the use of obsolete equipment, high employee turnover or non-cooperation, industrial unrest, lack of skills, training or qualifications, or absence of motivation) adds to cost inflation.
- Production cost increased by surge in government taxes, (such as company tax, indirect excise, etc) or by payment of higher interest rates on credit borrowed in order to expand business or finance new plants and equipment.
- Increase in the cost or raw material or by higher usage of utilities/services, such as power, telecommunications, transport, banking also increases the cost of production.

- Unfavorable climatic conditions also affect the production costs. For instance, the 2012-2014 droughts in Western Queensland limited the production and supply, leading to higher prices and production costs.

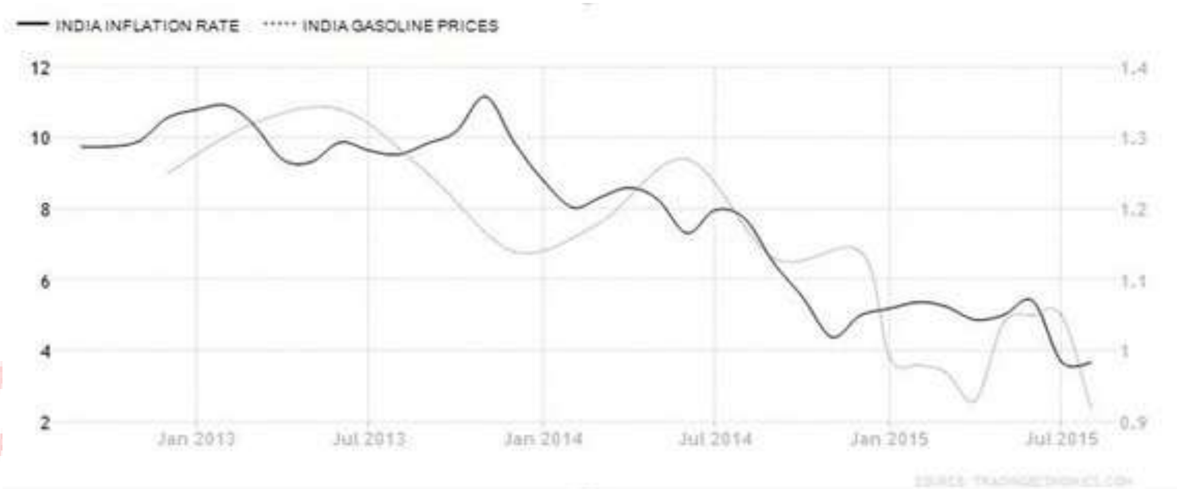
II. Causes of Inflation in India

Depending upon the influence they cast upon inflation, there are four kinds of factors that determine inflationary impact in a country such as India:

1. *Demand Factors*: Price rise occurs when the aggregate demand (AD) exceeds the aggregate supply (AS), and the large base of consumers chase limited number of goods and services. India being an agrarian society, where droughts, floods and inadequate methods of food grain storage leads to lesser productivity, the aggregate supply falls short to meet the aggregate demand in the country.
2. *Supply Factors*: Supply of various essentials is limited in India, which is one of the key factors for the rising inflation in the country. Agricultural scarcity, damage of goods in transit, high cost of labor, etc., lead to a multifold increase in the production cost of the commodity. Manufacturing and retail sectors are the two major industries that are facing the impact of inflation due to supply side constraints.
3. *Domestic Factors:* Owing to a lesser developed financial market that leads to a gap between output and real money, the probability of an inflationary pull in India is very high. The supply of money has a rapid growth, which is not met by the supply of goods and services in the industry.
4. *External Factors*: India has a liberal economic perspective, which as a consequence, leads the relevant exchange rate to determine the inflationary pressure in its economy. For example, if the prices of Australian goods increase, India would have to import them at a higher price. Such kind of a surge would, subsequently, increase the price of the goods in the country.

The aforementioned demand, supply, domestic and external factors severely impact the Indian economy by driving up its inflation. Few examples of specific causes for such price surge are:

- Being the second largest country in terms of population, there is a high demand for goods and services in India, necessaries and luxuries alike. Such high demand and inadequate supply has led to a high inflationary rate.
- The demand for oil and fuel in India is met solely through imports. Increase in their leads to limited purchasing capacity. It also leads to an increase in production costs, which raises the price of other goods and services. Following chart elucidates the comparative pressure upon Indian inflation rate when there is an increase in the gasoline prices:



- Changes in the Indian Foreign Direct Investment (FDI) policy led to an increase in the circulation of money in the economy, which created additional purchasing power and a higher demand for goods and services. However, the aggregate supply was inadequate for the corresponding demand, which increased the prices.
- Owing to a plethora of labour-welfare legislations, especially the MGNREGS, there has been a sharp increase in the wages of labourers. Although worthy in its intent, it cannot be ignored that such government schemes have led to inflationary pressure.

Government Policies

Government policies are an important tool to curb high inflationary rates in an economy. In both Australia and India, the respective governments play an active role to sustain growth at a level that it does not create excessive inflationary pressures

I. Policies adopted in Australia

The Reserve Bank of Australia has employed a pre-emptive monetary policy, in order to take immediate action against inflation before it poses as a threat to economic stability. This monetary policy is tightened by the RBA regularly, in response to the prevailing economic conditions, and is kept up-to-date. For instance, the monetary policy was revised eight times between 2005 and mid-2008 by the RBA, to curb demand-pull inflationary pressures on the Australian economy.
The centerpiece of RBA's monetary is to control inflation through an inflation target. Introduced in the early 1990s, such a target has provided direction and a framework for the decision-making process of the monetary policy. At present, the RBA intends to achieve an average inflation rate of 2-3 percent, which is believed to be ideal for the Australian economy.

Apart from the monetary policy, there are various other economic policies that have been employed by the federal government. Predominantly, there are two main types of frameworks that are used to pursue the goal of low inflation:

1. *Aggregate Demand Policies for Demand Inflation*

In case of demand inflation, the government uses contractionary monetary and budgetary measures to recede the excess levels of expenditure or aggregate demand (AD). Instances of such measures are:

a. Higher Interest Rates: As a contractionary measure in its monetary policy, the RBA changes the interest rates on credit in order to control national expenditure or aggregate demand. For example, such policy was implemented to reduce demand inflation during 2002–08. Higher interest rates discourage investments and private consumption and encourage private individuals to save more, thereby decreasing the AD.
b. Higher Taxes: The fiscal policy of the Australian government professes to increase the revenue through taxation to decrease the amount of expenditure in the economy. Such budgetary measures are brought through personal and company taxes.
c. Reduced Government Overlays: With an increase in the revenue of the government, the economic policy also dictates a corresponding decrease in its outlays and purchases. Such switch to contract surpluses, for example during 2002-08, has helped in controlling the inflationary rates.

2. *Aggregate Supply Policies for Cost Inflation*

When inflationary pressure is a result of high production costs, and not AD or expenditure, the Australian government uses microeconomic reform policies. These measures are intended to promote productivity, increase efficiency, and reduce the overall production costs of the goods and services.

a. Decreasing Tariff Rates: Liberalizing the economy and loosening the grip of tariff protection, increases business efficiency. For instance, in the year 1996, the government cut the general tariff rate down to 5% in order to lower the production costs of manufacturing and production units. Such lower rates encourage firms to bring a paradigm shift in their structure by reducing production costs and increasing overall efficiency.
b. Reforming the Labour Market: In order to maintain consistent production costs, the Australian government has ensured a simultaneous increase in the wage rate of labourers and the level of productivity. Introduced in 1991 by way of workplace agreements and enterprise bargaining, such a reform provides an incentive for the labourers to lift their productivity or efficiency.
c. Promoting Immigration: Due to limited supply of labour, the wage costs (and, subsequently, the production costs) in Australia are high. In order to solve this issue, the federal government encourages immigration of skilled and unskilled workers.
d. Encouraging training and education: To ensure maximum efficiency, it is paramount to have a workforce of skilled and educated workers. In order to maintain such a standard, the Australian government, in the year 2014, increased budgetary allocation to promote workplace training and education, and financial assistance to facilitate the system of apprenticeship.
e. Reduction of Company Tax: In order to lower the total cost of production, the government has time and again revised the company tax levied upon firms, starting from 36 percent and bringing it down to 30 percent in 2002.
f. National Infrastructure Projects: In the past decade, the government has established various infrastructure projects for the construction and development of roads, railways, water grids, communications, etc., in order to increase efficiency and lift the production costs for businesses.

II. Policies adopted in India

To reduce inflationary pressure, the main aim of the Indian government is to adopt measures that reduces the inflow of cash in the economy or reduces the liquidity in the market. There are kinds of measures which are followed in India:

1. *Monetary Measures*: The government has taken several measures to formulate a monetary policy in which the Reserve Bank of India increases the rate of interest on borrowings for commercial banks. The banks, as a result, increase their rate of interests on credit for the general public. Such a measure forces the public to prefer saving money rather than indulging in expenditure or investments. This reduces the money supply in the economy and curbs inflation.

   The monetary policy also includes making borrowing of funds more expensive and increasing the propensity to save by increasing the bank rate, directly controlling the rate of credit creation, performing Open Market Operations (OMO) and changing reserve rations.
2. *Fiscal Measures:* Apart from an elaborate monetary policy, the Indian government also uses a variety of fiscal measures. To control inflation, the government usually increases the taxes, in order to decrease total private expenditure. For instance, the imposition of direct taxes, such as income tax, will reduce the total disposable income of the individual and consequently reduce his spending.
3. *Price Control*: By increasing the prices of goods and services, the Indian government suppresses inflation. Such a measure, however, is not effective in the long-run and only exhibits results to bring a sudden drop in the inflationary rate.

On the practical front, the economic policy in India has been a result of a juxtaposition between the Indian government and its central bank. Inflation in India is predominantly consumption driven, where the overall consumption is tied with economic growth as well as public subsidies. To promote welfare and populist policies, the government provides a variety of subsidies to the general public on a variety of goods. This stance of the Indian government is in contrast to

Reserve Bank of India's attempts at moderating consumption by keeping key interest rates high. While the RBI seeks to curtail consumption expenditure, the government aims to promote it.

Conclusion

Inflation is a major economic problem with a stubborn, self-sustaining momentum in economies around the world. Australia and India are no strangers this phenomenon that have faced persistent and growing rates of inflation. Predominantly, both leading economies encounter *Demand-Pull Inflation* where the aggregate supply fails to chase the aggregate supply, or a situation of *Cost-Pull Inflation* where price increases as a result of high production costs. Such an economical pressure is experienced due to a variety of factors that range from demand-side factors, supply-side factors, domestic factors, and even external factors.

The impacts of a high rate of inflation in any economy of the world are negative. A high inflationary rate often contributes to a higher divide between classes of the economy with an uneven distribution of income among them. The economy, as a whole, faces a downfall and is incapacitated from operating freely. In order to curb the inflationary pull on the economy, governments as well as central banking institutions of the all countries, including Australia and India, work together to maintain a low rate of inflation so as to avoid the various consequences associated with a high level of inflation. On a practical scale, Australia has enjoyed relatively stable stakes in the twenty first century owing to effective and immediate action by the Australian government and RBA, whereas Indian inflationary rates respond slowly to most of the fiscal measures adopted by its government.

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