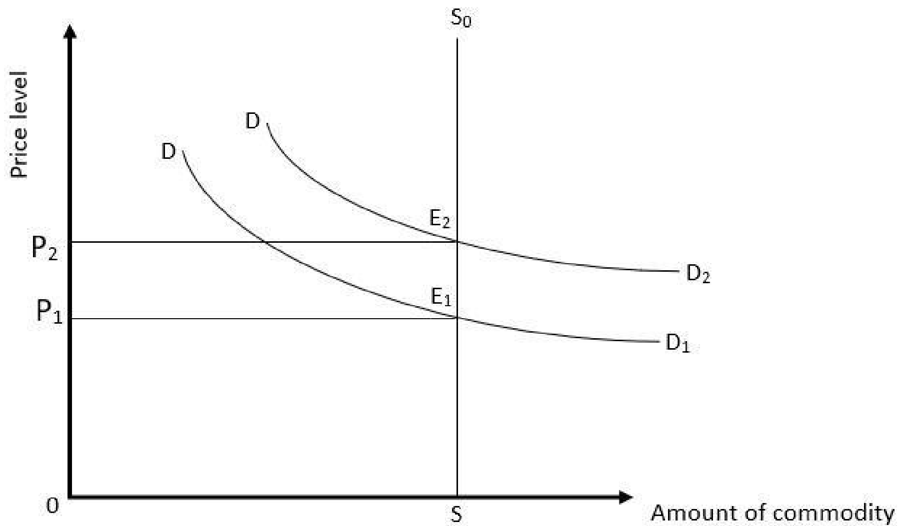
Explain briefly the theory of demand – pull inflation?

Ans: Demand – pull inflation: If the price level of the country rises continuously as a result of increase in demand for commodities but supply remain constant then that situation is called demand - pull inflation.

If total cost of the country (consumption expenditure + investment expenditure +Government expenditure) is greater than total production of less obtaining full employment then demand – pull inflation occur. In this situation it is not possible for the producer to meetup excess demand by increasing the production of commodity because it is not possible to increase production as the country is in full employment level. It can be explained with the help of following diagram: -



In the above diagram the plot price level on the vertical axis and amount of commodity on the horizontal axis in the above diagram **SS0** is the total supply curve of the commodity at full employment level. This supply curve is parallel to price level axis because amount of production and total supply of commodity remain constant **(0S)** at full employment level. In this diagram **DD1** in the initial demand curve of the society. It can be seen that it intersects the total supply curve at point **E1.** Here point **E1** is the equilibrium point, where equilibrium price level in **OP1 and** the equilibrium and of total commodity is **0S (**at full employment level).

Now total demand curve will move to the right if total demand of the economy increases. From the diagram it is seen that total demand curve shifts the right from **DD1** to **DD2**. It intersects the supply curve at point **E2.** Here **E2** is the new equilibrium point and the new equilibrium price level is **0P2.** However, at new equilibrium price level the amount of the commodity remains constant at **0S.** but price increases from **0P1** to **0P2** and production and supply remain constant due to full employment. In this situation total demand curve will shifts to the right as demand increases as result of this price level will increase continuously as the total supply curve remain fixed. This increase in price level is called demand pull inflation.

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