M.A. ECONOMICS : SEM-II
CC-8, MODULE-3
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STRUCTURAL THEORY OF INFLATION :

- PUT FORWARD BY– GUNNAR MRYDAL AND STREETEN
- EXPLAINED INFLATION IN TERMS OF DEVELOPING COUNTRIES LIKE LATIN AMERICA AND INDIA.
- THEY ARGUED THAT LDCS AND DEVLOPING COUNTRIES ARE CHRACTERISED BY STRUCTURAL DEFECTS , AND SO, TRADITIONAL THEORY ARE NOT APPLIED ON THESE ECONOMIES.

BOTTLENECKS IN LDC

- These structural bottlenecks or constraints create sectoral imbalances , which results in shortage of supply relative to demand and thus lead to rise in price level.

- <u>The structural theory explains three types of bottlenecks:</u>

1. Agricultural bottlenecks
2. Government Budget constraint
3. Foreign Exchange Bottleneck

1. AGRICULTURAL BOTTLENECK

- In developing countries food grains production do not increases due to bottleneck in agriculture , so, agricultural output is inelastic to rising income.

- Bottlenecks in agriculture includes

  a) disparity in land ownership and defective land tenure system.

  b) use of primitive technology in agriculture.

  c) lack of knowledge and access to finance.

  d) dependency on weather

  e) low agricultural infrastructural facilities

So food supply increases relatively less than increase in demand on account of increasing population or income. » AD>AS » gap » price rises » inflation

Further hoarding accentuates the prices up.

2. GOVERNMENT'S RESOURCE CONSTRAINT or BOTTLENECK:

Infrastructure, heavy industries and basic industries etc are undertaken by Govt, which require huge amount funds to invest. But countries faces resource gap on account of:

- A) Low tax base, large scale tax evasion, inefficient and corrupt tax administration.
- B) Insufficient external borrowings, grants and aids.

Lead to deficit financing » Ms (AD) » Output(*) do not increases(AS) » gap b/w demand and supply increases AD>AS » pushes the prices up » inflation.

3. FOREIGN EXCHANGE BOTTLENECK:

LDCs are characterised by shortage of foreign exchange or currency due to:

a) Dependency on import for their developmental activities like – capital goods, industrial raw material etc,

b) Exports of these nations are low due to low exportable surplus, poor quality product, restrictive world trade policies

- means, import >export ; payment > earning

- To fill this gap b/w export and import, LDCs opt
  1. restrictive import policies ---- to reduce import
  2. devaluation of currency----- to increase export

- Both of these measures lead to rise in price in the domestic nation.
- Leading to inflation.