



INFLATION THEORY: A THEORETICAL REVIEW OF DEMAND-PULL AND COST-PUSH INFLATION EFFECT ON NIGERIA ECONOMY

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ABSTRACT: *Inflation has become a pressing issue in Nigeria, affecting the cost of living and infrastructure development. Despite tight fiscal and monetary measures, inflation continued to rise at unprecedented rates in Nigeria. The present seminar paper aims to provide insight into the theoretical understanding of Demand-pull and Cost-push inflation and explore its causes and effects on the economy and individuals. Using the Desk research method, the researcher explores empirical data from 33 published articles for the study. The empirical literature reviewed found that Demand-pull and cost-push inflation are different and have different causes and effects on individuals and the National economy. It was found that Demand-pull inflation is driven by excess demand, leading to higher prices, while Cost-push inflation is caused by increased production costs, which result in higher prices. It was concluded that Inflation is a complex economic phenomenon that significantly impacts individuals and businesses. Understanding the differences between demand-pull and cost-push inflation is essential for policymakers and economists in formulating strategies to combat inflation and maintain a stable economy. The researcher recommended, amongst others, that developing appropriate policies and addressing the root causes of inflation make it possible to mitigate inflation effects and promote sustainable economic growth.*

KEYWORDS: Inflation, Demand-pull Inflation, Cost-push Inflation, Desk research, Sustainable economic growth.



INTRODUCTION

The continuous increase in prices of essential goods and services has led to a decline in the population's purchasing power, affecting their standard of living and resulting in the economic conditions of inflation. According to Garba (2023), inflation refers to the sustained increase in the general level of prices for goods and services in an economy over a specific period. It is commonly measured as the percentage change in the consumer price index (CPI) (Aberu, 2023) or the wholesale price index (WPI) over time (Sek et al., 2023). Inflation erodes the purchasing power of money, reducing the value of each currency unit.

When considering the subject of inflation, various factors contribute to it, including demand-pull inflation, cost-push inflation, and built-in inflation. The Keynesians, however, attribute inflation to changes in interest rates (Brochier, 2023; Ayisi & Afful-Mensah, 2023). Structuralists believe it is caused by agricultural bottlenecks and foreign exchange shortages (Onuorah, 2023). Meanwhile, the Cost-push proponents argue that it stems from increased production costs, such as wages, interest rates, imported raw materials, power supply, and transport, while Demand-pull inflation occurs when aggregate demand exceeds the available supply of goods and services, causing prices to rise (Sabran et al., 2023; Anagaw, 2023). Built-in inflation refers to the expectation of future price increases, resulting in wage demands and higher production costs (Dauda & Muhammed, 2023).

In Nigeria, the first experience of inflation in the country occurred in the 1970s due to the rise in oil revenue and increased public expenditure. Despite tight fiscal and monetary measures since then, inflation continued to rise at unprecedented rates (Adamu et al., 2023). As of May 2023, the country's Inflation rate, according to the Nigerian Bureau of Statistics (NBS) and Central Bank of Nigeria (CBN), stood at 22.41%, showing a year-on-year increase of 0.19% from 22.22%. The present seminar paper aims to provide insight into the theoretical understanding of Demand-pull and Cost-push inflation as well as provide a comprehensive understanding of its causes, effects, and how it differs from cost-push inflation.

REVIEW OF LITERATURE

Concept of Demand-pull Inflation

In the realm of economics, the dynamics of supply and demand play a crucial role in determining the prices of goods and services within an economy (Al-Musawi, 2023). When demand for certain products or services outpaces their supply, it can result in a phenomenon known as demand-pull inflation.

Understanding demand-pull inflation

According to Hassan et al. (2023), Demand-pull inflation occurs when the demand for goods and services exceeds the available supply. This situation leads to an increase in prices as businesses compete to meet the rising demand. When consumers have more money to spend, they are willing to pay higher prices for the limited supply of goods, resulting in inflationary pressures. This type of inflation is often associated with periods of economic growth and increased consumer confidence (Kalu, 2023).



Causes and Examples of Demand-pull Inflation

According to the empirical findings of Mbagwu (2023), Adeosun et al. (2023), and Ngetich and Mbuva (2023), the under-listed factors are the most common causes of demand-pull inflation in Nigeria.

1. **Real Output Gap:** The real output gap, which is the difference between actual and potential economic output, significantly impacts inflation. Demand outpaces supply when the economy runs above its potential output, leading to inflationary pressures.
2. **Money Supply:** The level of money supply in the economy plays a crucial role in deciding inflation. An increase in money supply without a corresponding increase in output can lead to excess liquidity and price rises.
3. **Government Expenditure:** Total government expenditure has a direct impact on inflation. Higher government spending can stimulate demand and put upward pressure on prices.
4. **Total Import:** The relationship between total imports and inflation is another important determinant. Increased imports can lead to higher demand for foreign goods, which may result in inflationary pressures.

Effects of demand-pull inflation on the Nigerian Economy

Demand-pull inflation can have both positive and negative effects on the economy. In the short term, it can stimulate economic growth as businesses experience increased sales and profits (Dokubo et al., 2023). In demand-pulled inflation, the high price results in higher revenue for businesses, in turn, help them advance business expansion plan and job creation. However, in the long term, demand-pull inflation can erode consumers' purchasing power and reduce their living standards. It can also lead to income inequality as those with fixed incomes struggle to keep up with rising prices (Ipinnimo et al., 2023). Furthermore, demand-pull inflation can lead to an imbalance in the economy. When certain sectors experience a surge in demand, resources may be diverted from other sectors, leading to inefficiencies and potential economic instability. Additionally, if inflation is not properly managed, it can create expectations of further price increases, leading to a self-perpetuating cycle of inflation (Appah & Tebepah, 2023).

Strategies to combat demand-pull Inflation.

To combat demand-pull inflation, policymakers can adopt several strategies. One approach is to reduce government spending and implement fiscal policies that curb excessive demand (Sekwati & Dagume, 2023). This can be achieved by reducing public expenditure, increasing taxes, or implementing austerity measures. Another strategy is to tighten monetary policy by increasing interest rates. Higher interest rates reduce the amount of money available for borrowing and spending, curbing demand and reducing inflationary pressures (Imandojemu et al., 2023). Additionally, policymakers can focus on increasing the supply of goods and services. This can be achieved through investments in infrastructure, promoting entrepreneurship, and supporting industries with the potential for expansion. Increasing the supply can restore the equilibrium between demand and supply, reducing the upward pressure on prices.



Concept of Cost-push Inflation

The inflation caused by a supplier's product cost is referred to as cost-push inflation. Nugraha et al. (2023) establish that Cost-push inflation is due to the shift of the aggregate supply curve towards the upper left. The factors that cause the aggregate supply curve to shift, according to Chirat and Clerc (2023), are the increasing prices of production factors (both domestic and foreign) in the production factor market, thus causing an increase in commodity prices in the commodity market. The cost-push inflation causes price increases which will often be followed by business lethargy.

Understanding cost-push inflation

Cost-push inflation occurs when there is an increase in production costs that leads to higher prices for goods and services. Unlike demand-pull inflation, which is driven by excess demand, cost-push inflation is caused by factors that increase the cost of production (Jacques et al., 2023). This type of inflation is often associated with rising wages, increased raw material costs, or changes in government regulations that increase production expenses (Yusnaini et al., 2023). An example of cost-push inflation can be seen in the oil industry. When the price of oil rises, it leads to higher production costs, which are then passed on to consumers through increased fuel prices. This, in turn, affects the prices of other goods and services that rely on transportation.

Causes and examples of cost-push inflation.

Standing on the empirical findings of scholars like Yusnaini et al. (2023), Isnowati et al. (2023), Chima (2023), and Tumala et al. (2023).

1. **Nominal Exchange Rate:** Changes in the nominal exchange rate can influence inflation. A depreciation in the value of the domestic currency compared to foreign currencies can raise the prices of imported goods, leading to higher overall inflation.
2. **Agricultural and Manufacturing Industries GDP:** The performance of the agricultural and manufacturing sectors can affect inflation. Bottlenecks in the agricultural sector and foreign exchange shortages can lead to supply constraints and higher prices.
3. **Interest Rates:** Fluctuations in interest rates can affect inflation. Higher interest rates can increase the cost of borrowing and reduce aggregate demand, thereby dampening inflationary pressures.
4. **Domestic Pump Price of Premium Motor Spirit:** The price of petroleum products, such as premium motor spirit (PMS), can influence inflation in Nigeria. PMS pump price changes can directly affect transportation costs and later impact overall price levels.
5. **Unemployment:** The level of unemployment in the economy can also contribute to inflation. High unemployment rates may lead to wage stagnation and reduced purchasing power, exerting downward pressure on prices.



Effects of cost-push Inflation on the Nigerian Economy

Cost-push inflation can significantly negatively affect the economy. Consumers' purchasing power diminishes as prices rise due to increased production costs. This can lead to a decrease in consumer spending, affecting businesses and slowing economic growth. Higher production costs also reduce business profitability, leading to potential job losses and reduced investments (Anachedo et al., 2023).

Additionally, cost-push inflation can create uncertainty in the economy. Businesses may become hesitant to expand or invest in new ventures due to the unpredictability of future production costs (Tumala et al., 2023). This can result in a slowdown in innovation and economic development.

Strategies to Combat Cost-Push Inflation.

To combat cost-push inflation, policymakers can employ various strategies. One approach is to reduce production costs by promoting technological advancements and efficiency improvements (Cristiano, 2023). By investing in research and development and providing incentives for businesses to adopt new technologies, the cost of production can be reduced, leading to lower prices for consumers. Another strategy is to address the root causes of cost-push inflation (Nugraha et al., 2023). For instance, if rising wages are a significant factor, policymakers can work towards improving labour productivity and skills. This can be achieved through education and training programs that enhance workers' capabilities and enable them to command higher wages without significantly impacting production costs.

Furthermore, policymakers can implement regulations and policies that promote competition and prevent the abuse of market power. By ensuring fair competition and preventing monopolistic practices, businesses are less likely to have the ability to increase prices without justification (Ghosh, 2023).

FINDINGS

From the literature, it is drawn that Demand-pull and cost-push inflation are different and have different causes and effects on the economy. Demand-pull inflation is driven by excess demand, leading to higher prices. It is often associated with periods of economic growth and increased consumer confidence. On the other hand, cost-push inflation is caused by increased production costs, which result in higher prices. It can lead to reduced consumer spending and uncertainty in the economy.

In terms of combating these types of inflation, the strategies differ. For demand-pull inflation, policymakers focus on reducing excessive demand through fiscal and monetary measures. Supply-side policies, such as increasing production efficiency and promoting competition, are crucial in combating cost-push inflation. The table below visualises these findings side-by-side.



ASPECT	DEMAND-PULL INFLATION	COST-PUSH INFLATION
Definition	Occurs when aggregate demand exceeds aggregate supply.	Results from increases in production costs or reduced aggregate supply.
Cause	Increased consumer spending, expansionary fiscal policies, etc.	Increase in the cost of inputs, such as labour or raw materials.
Trigger	Excessive aggregate demand.	Increase in production costs or reduction in aggregate supply.
Primary driver	Demand factors, such as consumer spending and government policies.	Supply factors, such as input prices or disruptions in supply chains.
Feedback loop	Positive feedback loop: Increased demand leads to higher prices, further increasing demand.	Positive feedback loop: Higher costs are passed on to consumers, leading to higher prices for goods and services.
Impacts	Rising prices, a potential increase in employment and output.	Rising prices and a potential decrease in employment and output.
Policy response	Tightening monetary policy, reducing government spending.	Addressing supply-side issues and implementing structural reforms.
Examples	Increased consumer spending and expansionary fiscal policies.	Rising oil prices, increase in wages, and natural disasters impacting supply.

CONCLUSION

Inflation is a complex economic phenomenon that can significantly impact individuals and businesses. Understanding the differences between demand-pull and cost-push inflation is essential for policymakers and economists in formulating effective strategies to combat inflation and maintain a stable economy. It is recommended that by implementing appropriate policies and addressing the root causes of inflation, it is possible to mitigate its negative effects and promote sustainable economic growth. Hence, policymakers must balance managing inflation and supporting economic development to ensure a prosperous future for all.

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