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Mini Guide to INFLATION

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If you were asked to discuss *inflation*, what would you say about it? Could you define it? Give possible yardsticks for measuring it? Tell what causes it? Give some remedies?

"Inflation is a condition of significantly or substantially rising prices," says one economist. When average prices go up 3 percent or more a year, the country is in a state of inflation.

Consumer price index is one tool to measure inflation. The Department of Labor checks prices throughout the country every month for 400 selected goods and services which the typical family buys. How these figures compare with the 1967 prices is shown in the consumer price index. If it costs $135 to buy these 400 selected goods and services that could be purchased for $100 in 1967, the consumer price index for the month is 135. Mass media reports this index each month.

Wholesale price index relates current wholesale prices to prices charged for the same items in the past. Future retail prices are forecast by this index, as extra costs are often passed on to the customers.

Inflation years were 1946, 1947, 1948, 1951, 1957, 1967 through 1974.

During World War II people saved money (it was the fashionable and patriotic thing to do because there was little to buy since manufacturers were busy making war goods). After the war, people rushed out and bought all sorts of things they had not been able to buy for five years. They were willing to pay almost any price. Manufacturers could not fill the demand and prices rose. As plants were converted from war goods to peacetime products, output rose and inflation slowed. There was no further period of sustained, serious (over 3 percent) inflation until the one we are experiencing now. This inflation was started in 1966 by the extra spending for the Vietnam War on top of the high level of spending by consumers, business, and government.

Factors that can cause inflation (or keep it going), working separately or together:

✓ People have increasing amounts of money to spend—incomes in general are rising more than prices.

✓ People are confident of the future and eager to buy things even if it means borrowing.

✓ Business is spending more in new plants and equipment, bidding up materials and labor prices. (When in production, the extra goods from these new plants will help slow inflation, but not now).

✓ Government is increasing its level of spending.

✓ Government lowers taxes.

✓ The output of goods and services is not rising as fast as demand for them.

✓ Higher costs of inputs (wheat for bread, oil for plastics, wages of labor).

✓ Productivity (output per man per hour) is not going up enough to match the higher costs. If productivity did increase enough, the higher costs would be divided among enough more units of that product so costs *per item* would remain the same and so could the price. It's costs *per item* that influences the price per item.

Who gets hurt during inflationary years? If inflation continues over a long period of years, everyone gets hurt. Even if your income rises, you are paying a larger percent of income as taxes. Over a short period of inflation those who feel the pocketbook crunch most are:

✓ *Retired people:* They are often on fixed incomes.

✓ *People with savings:* With a 10 percent inflation each $100 in savings buys only as much as $90 would have bought at the beginning of the year. The interest people earn on their savings often is not enough to make up for the dollars of lost purchasing power, and thrift is undermined.

✓ *People who own bonds* (government or business): If interest rate on bonds is less than the inflation rate, these people lose purchasing power.

✓ *Low-income people:* After paying inflated prices for food and housing, there is little left for other things.

✓ *Employed people:* If wages do not keep up with the inflation rate, workers lose.

Who wins during inflation?

✓ *People who owe money:* A $100 debt can be repaid with dollars having the purchasing power of $90 if there is a 10 percent inflation. Real estate mortgages are often viewed as a benefit to the borrower in times of inflation.

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√ *People who own real estate* usually benefit because, for many kinds of real estate (but not all), prices tend to rise. This is only one factor in evaluating real estate.

During inflationary periods, everybody tries to beat the game. Interest rates go up; wage earners ask for more money; people save less. People earn more, but prices are up and nobody is better off.

Inflation is an international problem. It disrupts planning for the future. Worst of all, it makes a mockery of those things that make a people and a nation strong—hard work, saving, and planning.

There is another factor that affects the economy—what people do when they expect prices to continue to rise rapidly. People may want to borrow to buy, business builds big inventories, and workers demand increased wages. All these actions can cause more increases in prices.

What can families do to live with inflation?

√ Increase their earnings (higher pay or change to a better paying job) or increase the number of wage-earners.

√ Do without some products and services of less importance to them.

√ Compare prices and quality of products and services to get the "best buy."

√ Make and do more things for themselves.

√ Watch to see their use of credit does *not* expand faster than their incomes.

√ Use public services.

√ Make things last longer by care and upkeep.

√ Do not waste what they have.

To slow down inflation we must reduce total spending, increase total output, or both.

1. People need to see that their use of credit does not expand faster than their incomes.

2. Business can produce more goods and services.

3. Business and labor should attempt to increase their *productivity* so they can increase output and not raise prices.

4. Government could:

Increase taxes, thus reducing consumer spending.

Reduce government spending.

Balance budgets—no deficits.

Establish consumer credit controls. Increasing the down payment required and shortening the loan period for cars and other consumer products would lessen the demand.

5. Federal Reserve System (our central bank) can:

Reduce the amount of loanable funds local banks have; fewer loans, less spending.

Raise the interest (discount) rate so fewer people and businesses want to borrow and spend.

In periods of severe inflation the government may ask for price and wage freezes, as in the early 1970's. Economists differ widely on the desirability of such controls.

When incomes do not rise as fast as prices, purchasing power drops, so families must cut the quantity they buy. As demand for goods and services slackens, the inflation will cool, so prices will not go up so rapidly, say only 6 percent a year rather than 10 percent. But not many prices will actually drop. To put it another way, the inflation *rate* will slow down from 10 percent to 6 percent. Most economists feel that prices can be expected to rise 5 percent or more each year for the rest of the 70's—an inflation rate of 5 percent annually.

With less demand for goods and services new problems develop:

√ *Unemployment:* Young workers, women, and minority groups suffer first.

√ *Home building, related industries, and small business* are sensitive to reduced funds for loans and high interest rates. Fewer houses are built and sold.

The challenge will be to lessen these problems without increasing inflation.