

Re: Do I understand (the basics of) inflation correctly?

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From: The Trucker (*mikcob_at_verizon.net*)

Date: 02/09/05

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Bill wrote:

> *"The Trucker"* <mikcob@verizon.net> wrote in message

> *news:cubovs018sc@news1.newsguy.com...*

>> *Bill wrote:*

>>

>>>

>>> <xyzer@hotmail.com> wrote in message

>>> *news:1107823142.865537.213970@c13g2000cwb.googlegroups.com...*

>>>> *Ok, here's the way I was taught to think about inflation in*

>>>> *macroeconomics class. Tell me if I basically understand things*

>>>> *correctly:*

>>>>

>>>> *Inflation is a monetary phenomenon caused by increases in money supply*

>>>> *growth -- period. This does not mean average prices cannot rise for*

>>>> *other reasons. Thus, just because average price levels rise, this does*

>>>> *not necessarily mean the increasing prices were caused by an increase*

>>>> *in money growth and thus inflation.*

>>>>

>>>>

>>> *That's not normally the definition used for inflation. It is typically the*

>>> *level of prices.*

>>>>

>>>>

>> *The money growth thing is more correct than the price rise thing.*

See

>> *below.*

>>>

>>>

> *It is hard to argue with a definition. You are arguing that the definition*

> *should be different.*

>>From GreaterVoice...inflation

It must be constantly recalled that inflation is anywhere and everywhere a monetary phenomenon. That inflation is that dimension of prices that can supposedly be controlled by varying the "interest rate" of credit, by varying the amount charged for entrepreneurial "investment" in the provisioning of more "goods", or by creating or extinguishing money. This claim is constantly repeated in that when our masters of misdirection speak of inflation they claim that it is something that can be caused or cured by messing about with interest rates and/or the amount of money in The Economy. Never will you hear the talking heads mention "inflation" without mentioning interest rates or the Federal Reserve

So make up your alleged mind(s). You can't have it both ways. If interest rates are the cure for inflation then it MUST be a monetary phenomenon.

An increase in interest rates is NOT going to reduce the price of oil.

> >>> *Second, I was taught inflation in and of itself is actually, and all else equal, not generally a "problem" on a macro scale. That is, in general, wherever you can find someone who's hurt by higher-than-expected inflation, there will also be someone in that exact case you find who will have been helped by it. The classic example is the person paying on a fixed mortgage. If you assume that higher-than-expected inflation benefits the person paying on the mortgage, since he gets to use dollars of increasingly lesser value to pay it off, then you also assume the person receiving the money of lesser and lesser value is worse off. Of course, a nominal interest rate can be approximated by adding the real interest rate plus the expected rate of inflation (plus other things), so that generally speaking people try to protect themselves from losing because of inflation. But some people do lose and some people win when inflation rises more than expected. It's just that on a macro scale it all evens out. It becomes I guess sort of like a zero-sum phenomenon. That is, when you sum the benefits and the losses of the people of the world, it*

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> >>> *ends up being zero. Of course, if you consider the places where there*
> >>> *is incredibly rapid inflation or changes in inflation, where people*
> >>> *constantly have to spend significant amount of time to keep up with*
> >>> *the changes, then this would be a cost to society to consider.*
But
> >>> *this kind of cost is really something besides inflation in itself, and*
> >>> *generally not significant in most countries. Of course, inflation can*
> >>> *be seen to go along with many economic troubles in the world, but*
> >>> *inflation generally is not the root cause of the problems, even where*
> >>> *it might appear to be.*
> >>>
> >>
> >> *I would think in an economy with run away inflation every one is hurt just*
> >> *because it disrupts the economy – not that you can't keep up but you can't*
> >> *do business. On a country wide scale, I'm pretty sure it is not true*
> >> *either. Take the the example of gas prices rising due to arabs increasing*
> >> *the price of oil. They win, we lose.*
> >>
> >> *Bill*
> >
> > *1. Gas is not actually tied to oil as closely as you seem to think.*
> >
> > *2. An increase in the price of either one is not necessarily*
> > *a _cause_ of or a sign of inflation. (this is why rising prices*
> > *are _not_ synonymous with inflation and why inflation is not*
> > *just rising prices)*
> >
> > *3. If more money is not supplied to the economy then the prices*
> > *will remain constant overall and those things that use the most*
> > *oil will cost more and those that don't will get cheaper or they*
> > *will disappear.*
> >
>
> *Could you explain that. Why would, say, something like logs used for heating*
> *get cheaper if oil prices go up? Or water?*

If there is only a certain amount of money and products in circulation then any rise in the price of one product must be offset by a fall in the price of some other product or there must be fewer products. There simply is no other way for the price of one given product to rise. The

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money must come from decreased spending on other things. Thus, no overall price increases and thus no "inflation" if "inflation" is defined as "a rise in the general price level".

Bill

>
>> *It is appropriate to add more money thus balancing the rising
>> prices between established money and labor. The prices rise
>> and wages rise somewhat. The holders of money lose a little
>> and the workers lose a little and the rentier (the oil "owner")
>> does not win as much as he otherwise would have. The price
>> of oil is higher in dollars but the dollars are slightly less
>> "valuable" than they were.*

A rise in the general price level calls for more money in circulation (or perhaps a higher velocity?).

>> <http://GreaterVoice.org/econ/glossary/inflation.php>
>>
>>>> *Would most people agree with this in general or pretty much call
this
>>>> analysis way too general (or completely flawed) to apply to the
real
>>>> world? Do most economists think this way in general?
>>>>
>>
>> --
>> "I know no safe depository of the ultimate powers of society but
>> the people themselves; and if we think them not enlightened enough
>> to exercise their control with a wholesome discretion, the remedy
>> is not to take it from them, but to inform their discretion by
>> education." – Thomas Jefferson. <http://GreaterVoice.org>*