XIV: EFFECTS OF INFLATION

The causes of inflation are complex, and so are its effects. Some of these have been mentioned already, but we must still examine inflation's effects on:

current incomes,

savings,

borrowers, and:

the government.

Inflation and Current Incomes

New currency may be passed into circulation to balance an increase in prices and wages. Alternatively, it may flow into the country from overseas or through the banks, or be created to finance a government deficit. New money from these last three sources actually causes wages and prices to rise.

Inflation, whatever its origin, has only a marginal effect on anyone whose income is adjusted periodically, in line with changes in the Consumer Price Index. Such persons receive a boost in monetary income whenever the currency is debased, but this is largely negated by the increased prices. In the end the purchasing power of their incomes remains about the same as before.

Savings and Inflation

The situation is vastly different with incomes derived from savings - as the value of savings is reduced by inflation.

This effect is almost catastrophic when double digit inflation becomes a fact of life. For instance, if anyone held $A1,000 for six years from 1972-73, then his savings lost more than half their value. By 1978-79, the $A1,000 would purchase only what $A452 would have bought in 1972-73.

Borrowers and Inflation

The main consequences of this will be discussed in detail later. Here we note: "It's an ill wind..." - because the inflation that debilitates savings provides a definite advantage to borrowers.

Thus, a man who borrows $1,000 when his wages are $100 per week, has borrowed the equivalent of ten weeks' work. If inflation doubled his wages, he could repay the loan with only five weeks' pay. In this way inflation - over the years - has helped many borrowers to eliminate their debts.

Inflation and the Government

The governments of most countries are heavily in debt, so inflation helps governments just as it helps the private borrower. At the same time inflation increases taxation revenue.

Taxes are usually calculated as a percentage of incomes, prices, payrolls or sales. Therefore, if prices and wages rise, then taxes rise in line with them. In addition, inflation lifts many individual and company incomes to levels at which a higher rate of income tax or company tax applies - thereby increasing revenue in a third way.

Finally, as noted already, new money can be issued to cancel a deficit. Such new money is really a hidden and indiscriminate form of tax. This tax is levied on everyone who holds money while the currency is being debased. If deficit financing adds 5% to a nation's annual inflation rate, then anyone who holds $1,000 is contributing $50 to the government each year.

Savings and Pensioners

These benefits to the government are partly offset by an increase in the number of pensioners.

Inflation - especially double digit inflation - makes it difficult to provide for future needs by saving money. Inflation therefore forces many people onto the pension, when they could have lived in retirement on their savings if the currency were stable. The additional pensions add to government expenditures and consume some of the revenue supplements mentioned above.