

PRICE INFLATION

Inflation is a rise in the general level of prices in a macroeconomy; it always results in a redistribution of income. Compared to the problems associated with unemployment, inflation is pretty tame. With widespread unemployment, almost everyone in the economy loses. With inflation, when one person is paying higher prices, that **MUST** mean that someone else is receiving more income. Inflation is, above all else, a manifestation of the struggle over income distribution.

But, is that a problem? After all, one of the built-in incentives of the market system is the ability of those who are making goods and services that are in demand to raise their prices, and therefore their incomes. In that case, rising prices are simply the manifestation of a process that we all believe to be just and fair. Problems arise, however, when firms and workers are able to raise their prices even when their products are not in high demand. This happens when firms and workers have *market power*, or the ability to avoid competition.

High rates of inflation add an additional cost in the form of the confusion created in price signals (i.e., it's difficult to make many plans when prices are changing constantly).

Inflation Summary:

	Demand Pull	Cost Push
How it works	Rising demand “pulls” prices up (especially when employment and capacity are high and firms cannot easily produce more)	Rising costs of production (including wages and profits) “push” up prices of final products from below. This can occur with stable or even falling demand.
Who gains	Those whose products are in highest demand	Those with market power
How it's stopped	By stopping demand (which is accomplished by inducing a recession—our government usually chooses to do so by raising interest rates)	By directly addressing market power. This can be accomplished with anything from threats to direct controls.
Orthodox view	Most inflation is of this variety; it's a big problem because it creates confusion. Must be stopped.	Very rare.
Institutionalist view	It occurs, but as a bad side effect of an otherwise welcome phenomenon (i.e., full employment).	Big problem as it redistributes income on a basis that runs counter to the spirit of capitalism.