STUDY PAPER NO. 7

THE INCIDENCE OF INFLATION: OR WHO GETS HURT?

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Chapter 1. General Summary

In this paper, I am concerned with the problem of the effects of inflation on different groups of the population. My major interest is, of course, the inflation that has confronted the country in recent years. In order to get some measure of the effects of inflation on different groups, I have also had to take into account earlier inflations and to consider what happened as prices rose.

I should say at the very outset that it is not always easy to disentangle the effects of inflation from other forces. For example, through long periods of our history we have not only had a modest amount of inflation, though there have been important periods of deflation, but we have also had rising gross national product (GNP) associated in part with an increase in population and in part with the growing productivity of our economy. Often the damage done by inflation results from its contribution to a failure to adjust prices or incomes of various groups to the general trends in the economy. But if average per capita income is rising and if returns to some elements in our economy lag in relation to the growth of the economy, and if on top of the increase in productivity there is also a rise in prices, then the failure to achieve adjustments may be aggravated by the rising prices. Again we may find, for example, that the adjustment to rising prices or even to rising per capita incomes has been more than adequate in some segments of the economy. But the explanation may be in part that, for example, benefit payments in a new social security program had been most adequate at first; and it takes time to adapt benefits to the general standard of living. It may then be found that benefits rise more than the price level and yet a correct analysis may very well suggest that, in the absence of inflation, benefits would have risen more in relation to the real standard of living. In other words, what seems to be a response to inflation or to a rising per capita income may, in fact, be an attempt to adapt our benefit structures to the current standard of living.

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