

Not only is inflation continuing on a broad front this year, but its pace is accelerating. Moreover, inflation has changed in form. Unlike its 1965-66 demand-pull character, inflation last year turned into cost-push as a wage-price spiral was set in motion by leading labor contract settlements that established wage gains twice as great as productivity improvements.

Despite the tendency for inflation to be self-perpetuating, the argument is sometimes heard that our historical record justifies confidence in a reasonably stable price level. Those who argue this way point to the fact that 82 percentage points of the 130-percent rise in prices in the past three decades reflected wartime conditions during World War Two and the Korean war. But adherents to this viewpoint acknowledge that since World War Two the price level has neither leveled off nor declined. This is the "creeping inflation" phenomenon, some of which Arthur Ross, the U.S. Commissioner of Labor Statistics, has attributed to an upward bias in consumer price statistics as currently compiled. But this bias accounts for only about 1.3 percentage points of the average annual Consumer Price Index increases of 1.9 percent since 1961 and the current annual rate of 3 to 3½ percent. The difference remains to be explained.

WHICH PRICES ARE RISING?

A price index is an average; and averages can conceal as well as reveal what they are intended to measure. The Consumer Price Index, for example, is made up of several subindexes, including the cost of medical care, food, homeownership, apparel, and upkeep. Some of these costs have risen much more than others. For example, the fastest rising cost has been medical care, a labor-intensive item, which in December 1967 was almost 26 percent higher than in 1964—up almost 9 percent a year. On the same comparison, food prices rose 5 percent a year; homeownership 4 percent; and the item, "apparel and upkeep," rose 3½ percent. As previously indicated, all items combined rose about 3 percent per year. Individual items in the wholesale price index behaved in a similar fashion, with the prices of hides and machinery and equipment rising fastest.

Changes in prices of individual items reflect underlying shifts in demand and supply. Demand-supply analysis of the sharp rise in medical costs shows that the faster increase in demand for these services, partly due to medicare and medicaid, has exceeded the increase in the supply of skilled personnel and medical facilities. On the other hand, the fast rise in the price of hides has been attributed more to international supply than to demand conditions. But a general rise in prices, as measured by a broad index or average, reflects economy-wide changes and not simply forces affecting a few industries.

THE PROCESS OF INFLATION

There are two popular explanations of how inflation starts and is propagated. The first explanation, called demand-pull, stresses a faster increase in money spending than can be quickly translated into increased output. Such a rapid rise in overall money spending is brought