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The Economy and Me: Inflation

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Inflation is a worldwide problem. Everyone is affected. Inflation is an increase in the general price level of goods and services that continues over a long period of time. Many people want to help, but it's hard to know what can be done, and whether any action will make a difference.

Before we look at specific actions to help you, as a family member, let's look at the economy and your part in the economy.

Since inflation influences you in different ways, let's look at the roles you have in the economy. You are a (1) worker-earner, (2) consumer-spender, (3) investor-saver, and (4) taxpayer-citizen.

**WORKER-EARNER**

As a worker-earner you want to get the most income you can. In many cases the escalation clauses of contracts provide for wage increases as inflation increases; therefore, your total wage increases in relation to the rate of inflation. Escalation clauses, sometimes called cost-of-living clauses, are tied to increases in the Consumer Price Index (CPI). For example, the wage earner receives a 6 percent increase if the CPI has increased 6 percent over the past nine months. Each contract has different stipulations, but they are all stated in relation to the CPI. So, if you are covered by such a contract, your real income (gross income adjusted for inflation) is the same or possibly higher than a few years ago. But, if you are not covered by an escalation clause, you may have less real income now than you did a few years ago or even last year.

**CONSUMER-SPENDER**

As a consumer-spender you bear the brunt of inflation. As the price of goods and services increases with the rate of inflation, you, the consumer, pay more. Thus, the purchasing power of your dollar is decreased, and you have less for the same amount of money. In other words, your REAL INCOME has decreased. Everyone is a consumer, and so everyone is affected.

The prices of goods and services, however, increase at differing rates. For instance, from 1978 to 1979 the prices of food items increased 10.8 percent while clothing prices increased 4.4 percent and medical costs increased 9.3 percent. The average price increase for all items purchased during the same time period was 11.3 percent.

The effect of inflation on you and your family will depend on the goods and services you purchase. For example, you may spend a larger percent of your income for food than your neighbor, so inflation would hurt you more because food prices are more inflated (10.8 percent) than are the average costs of goods and services prices (11.3 percent). Do you know how much you spend on the different goods and services?

**INVESTOR-SAVER**

The effects of inflation on you in the investor-saver role is somewhat harder to evaluate. Just as the rate of inflation on goods and services varies, the rate of return on investments also varies. You must weigh many factors before selecting the best investment for the amount of money available. These factors include the rate of return (interest, appreciation, yield, etc.) and the amount of risk for each type of investment.

The purpose of this bulletin is not to examine each kind of investment available to you nor to figure the return of the investment, but to make you aware that the effects of inflation for the investor-saver role may be different than for another role. A tool many people use to analyze investments is the "rule of 72." This tool helps you discover how many years it takes to double the investment at a given rate of return. To figure the number of years, divide 72 by the rate of
return. For instance, it takes 14.4 years for the dollar to double at a 5 percent rate of return \((72/.05 = 14.4\) years).

This same rule can describe the effects of inflation. At a 5 percent rate of inflation the value of the dollar will be cut in half in 14.4 years.

**CITIZEN-TAXPAYER**

The citizen-taxpayer role can be examined from two points of view. One is the amount of tax you pay, and the other is the amount of government services you receive. As the rate of inflation increases, most wage-earners receive a higher income. Thus, if you are receiving a larger gross income than last year, you pay a larger percentage in taxes because your taxable income is larger, and you also may be in a higher bracket. This is true for the Federal income tax and any other progressive income tax system which requires that a higher percent of tax be assessed, as the income increases.

As inflation increases, incomes usually rise; and a progressive tax system based on gross income ignores the fact that real income may not have increased. Thus, it has been suggested that Federal income taxes be based on real income or some other base which does not include inflated dollars. This concept is often referred to as “indexation.”

On the other hand, if you are receiving a transfer payment from the government (Social Security or veterans’ benefits, for example), you may benefit from inflation. Many transfer payments increase as inflation increases. So your position is not changed unless the government reaches a point that they do not have enough income (taxes) to pay the outgo (government spending which includes transfer payments).

You can see that inflation affects many different aspects of your life, depending upon the role you are playing. Remember, the goals of worker-earner and consumer-spender are opposite. A wage increase without a productivity increase will only send consumer prices higher. In the same manner, the investor-saver and citizen-taxpayer goals have conflicting components. In today’s inflationary times, any interest earned on savings is usually less than the rate of inflation, and, then, it is still subject to taxation which decreases its value still further.

The consumer-spender and citizen-taxpayer are also in conflict in several areas. You want to consume more goods and services provided by the government, but still have low taxes. Goods and services provided by the government include: parks, libraries, highways, public transportation systems, research that leads to control of diseases, national health care for all persons, higher Social Security benefits, CETA jobs, food stamps, youth programs, price supports for farm commodities, land set-aside programs, etc. For each good, service or program you desire from the government, you should be prepared to pay increased taxes. If you do or do not want to pay for these things, you should become informed, then write your congressman to express your views.

**WHAT CAN YOU DO?**

You can have some influence on the economy. Max Lerner, an economist, has said that “inflation is us.” He suggests that most of us view inflation and the conditions existing in our economy as a monster. We view it as uncontrorollable and mechanical to the extent that it can’t be stopped. But inflation is not produced mechanically, but rather by humans. Lerner also states that “three-fourths of inflation is psychology and politics, and much of the other fourth might as well be.”

We can do something about the economy by doing something with ourselves through self-knowledge, self-restraint, and self-control. How would this work for each economic role?

As a worker-earner, be aware of your job, job skills, and opportunities to improve your salary, wages, and working conditions. You can help reduce inflation by increasing your productivity along with each pay increase. If you ask for a pay increase just because prices have increased, then you are helping to create inflation. Many people are suggesting that wage contracts should be tied to productivity rather than to increases in inflation. This would help to reduce inflation, and might help to reduce the risk of a recession. It also might put our economy back in competition with countries that are more productive than we are. What can you do? Be the best worker you can, and be proud of the work you do.

As a consumer-spender, ask yourself if you are living beyond your income. Many of us are “caught up” in our high-consumption pleasure society.

Start by analyzing your spending patterns. Look at how you spend your money. Ask yourself “Is this item a necessity, a desired item, or a luxury?” A necessity is something you absolutely must have to live. Also, look for ways to cut your spending. If you cut your spending on some items, then you will have money for the things you desire.

**WAYS TO REDUCE**

Simplify your life. Ask yourself: “Do I really need this item?” If the answer is “no,” then ask yourself: “Why do I want this item?” “How much do I want this item?” “Am I willing to do without this item?”

Reduce the amount you use. It doesn’t matter what the item, with the exception of some medications, in most cases the amount consumed can be reduced. Think about the things you buy. With what can you use less? What can be eliminated com-
pletely? We are a society which in recent years has been governed by the philosophy of “bigger the better.” Now a new philosophy of “small is beautiful” is beginning to be the way of life for many. Which philosophy are you using today? Which one will you use tomorrow?

Switch from one item to a less expensive version. For example, an appliance with fewer “options,” especially when you won’t use all of them, will cost less initially and probably have fewer repair costs.

Share goods and services. You might find someone to share the goods and save costs for both families. For example, seldom-used items like lawn equipment, a snowblower, or ice cream freezer could be shared. But remember, expect some inconvenience, and make agreements for the upkeep of the item. Sometimes the food items purchased in quantity for a lower unit price can be shared with others. For example, a bushel of apples can be divided into smaller quantities for convenience and savings. If the inconvenience of sharing is greater than the savings from sharing, don’t share. Find another way.

Borrow. You may borrow a durable item from someone to save money. You also should be prepared to lend an item you own to the person from whom you borrowed. Keep in mind this can be suitable for some items you own, but not for all items. Delicate items, especially valuable items, or items demanding a high skill level to operate may not be suitable to lend.

Rent the item. You might rent from a friend or your local rental business. If this is something you need only once or twice a year, then it is probably best to find an alternative to owning the item. Renting, borrowing, or sharing with someone else are alternatives.

Substitute a related product for what you need. For example, instead of buying another car, ride with someone; use public transportation, or form a car pool. If this is not suitable, be creative in arranging for the use of the family car. Also, some people might substitute sleeping in a tent for a vacation in a hotel. Many food items also have substitutes.

Remember, if the substitute is not perfect, everything equal, then you must be willing to accept the difference. Ask yourself, “How important or necessary is the ‘real thing’?” Also ask, “Is the substitute suitable and acceptable to me?” If it is not, then you may have wasted your resources, time, money, and human energy on the substitute.

Would you rather do without an item than to compromise by switching or substituting? Know yourself and your spending patterns. Then, and only then, can you make the choices that will leave you satisfied with your way of life.

Not all the ways to cope with inflation will be acceptable to you. Your income may already be stretched, and you have “cut your spending” so that you think nothing else can be done. If you are keeping records and analyzing your spending, then this may be the case.

If you are not keeping records, how can you know where your money goes month-after-month? There are “leaks” in your spending. Only you can “plug” the flow with knowledge about your financial situation.

As an investor-saver you must be knowledgeable about the alternatives and the laws affecting the returns on your investments. Our country needs more people saving so that money can be borrowed to build new homes, businesses, etc. and thus create new jobs. But in our inflationary economy, people are spending more and saving less, so the rate of saving for the population is low. In other economies around the world when inflation starts to creep upwards, the citizens of that country start saving, and the inflation rate soon stabilizes. If we in the United States could take a lesson from Germany or Switzerland, then we could help to control inflation here.

As a citizen-taxpayer, you hold the key to controlling inflation. You elect the officials in your local, state and national governments. They make the laws that determine much of the spending of the government(s). Become knowledgeable about what is going on; how they are spending your money. Remember, for every time you ask the government to do for you or others, your taxes pay for that good or service. Let them know how you feel. It’s your money that is given to the government to be spent by the people you elect.

Can you see how the roles we play are not compatible? Can you see why special groups lobby to have laws changed that will improve the quality of life as a worker, consumer, investor, or citizen? But in most cases, the bottom line is more inflation for us all. Milton Friedman, an economist, has said, “Inflation is a form of taxation that has one very special feature. It’s the only form of taxation that can be imposed without anybody voting for it.”

You have a part to play. If you believe as Max Lerner that “inflation is us,” then your self-knowledge, self-constraint, and self-control, along with making knowledgeable opinions known, will help to influence the rate of inflation and thus make a brighter and more secure future for yourself and family.

REFERENCES:


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