S U N D A Y I N D E P E N D E N T No.TWENTY-FIVE

SOURCES OF INFLATION

John Hyde

Most people agree that inflation is a thoroughly bad thing; there is less agreement about where it starts and who, in a final analysis, should be held responsible.

The difficulty in putting a finger on a first cause is not only that we must choose between explanatory theories, but that the various 'causes' develop from each other in a continuing cycle. It is very like an extension of the chicken and egg problem, ending with a barnyard full of starving chickens and buckets of undersized eggs.

Depending on their political inclination, those who see inflation as caused by rising costs have blamed rapacious businessmen, trade unionists, oil sheikhs, and international markets. Monetarists blame an excessive supply of money. While few people these days would argue that money supply has no bearing on average prices, monetarist theory says nothing about which prices, around the average, will rise most and which least. (During recent high inflation, farm prices actually fell.) Monetarist theory itself says nothing about why politicians and monetary authorities should want to increase the supply of money.

A more sophisticated view, in effect, combines costs with monetarist theory by considering the effect of rising costs on political behaviour. This view notes that as wages are forced, by the monopoly bargaining strength of trade unions, above a level at which everyone can be employed, political authority will expand the money supply deliberately or inadvertently, causing inflation to nullify wage increases. Through the sixties moderately rising inflation kept Australian unemployment almost at bay, but in the seventies wage indexation made the process impossible as each inflation automatically and quickly caused further wage rises.

Whatever camp one enters, it is important to know from whence inflationary pressures come. Even the purist monetarist would agree that if one sector has a capacity to expand its prices faster than an average determined by money supply, other sectors are squeezed.

The Australian Institute for Public Policy (AIPP), a Perth based research foundation, has divided the Consumer Price Index between public and private sectors. In Perth, during 1983, public sector prices rose 13.5% while private sector prices rose by only 6.7%. Not only does it seem as though the government itself is a large part of our inflation problem, but so marked a difference is utterly unsustainable. If it is not the case already, it must be a matter of time only before the quarter of the CPI index which was classified as public sector squeezes the three quarters classified as private into unprofitability and decline. If the private sector cannot continue to improve its productivity at twice the rate of the public sector, government charges must kill off those bits of the private sector least able to improve productivity. It is frightening.