
Time To Focus On Inflation
by Jordan Cash

Pundits and politicians often focus their attention on tax, regulatory, and fiscal policy when debating how to help the economy out of its current slump, yet they have neglected to consider the immense importance of monetary policy. By not considering monetary policy, our leaders act in ways that may solve immediate problems, but leave us vulnerable to the insidious effects of inflation.

Since 1977, the Federal Reserve has been tasked with stabilizing prices and insuring maximum employment.[1] Yet this dual mandate often leads to policy actions which are counterintuitive. The actions of the Fed in recent years-quantitative easing, phases one and two, "Operation Twist," and holding interest rates to historically low levels-were all meant as ways to stimulate spending and decrease unemployment. However, by chasing a low unemployment rate, the Federal Reserve has created an environment for higher inflation. Ben Bernanke, Chairman of the Federal Reserve Board has even admitted that the Fed may act not act to control inflation as quickly if they can decrease unemployment.[2]

Currently, the Fed's stated goal is to keep inflation around 1.5-2 percent, a goal they have failed to achieve as March's inflation rate was 2.7 percent.[3] This rate is based upon the consumer price index (CPI), which is fairly exclusive in the commodities it examines. A more inclusive approach-such as the one used by the Bureau of Labor Statistics (BLS) before the calculations were changed in the 1980s-estimates that inflation is closer to 10.3 percent.[4] This correlates to the input cost inflation experienced by large food companies such as General Mills, who recorded an inflation of their input costs by over 10 percent this past year.[5] The American Institute for Economic Research (AIER) also disputes BLS numbers, using an inclusive "Everyday Price Index" (EPI); under EIP, they estimate inflation around 4.1 percent, with a 1.9 percent increase in March alone.[6]

While Bernanke and the Fed may be willing to tolerate rising inflation in a gamble to improve employment, that does not change the fact that inflation is incredibly dangerous for economic health. Inflation from Fed policies constitute a hidden tax on consumers as prices for goods and services increase-particularly food, medicine, and energy.[7] The BLS index monitoring food and energy prices has been rising steadily for over a year, and in the past five years electricity costs have increased to their highest level since 1996, the largest sustained increase since the 1970s energy crisis.[8] When it comes to consumer prices as a whole, AIER estimates that if current inflationary trends continue, prices will likely increase 22.8 percent on an annualized basis.[9] These prices indicate a devaluation of the dollar as well as high fuel prices-itself partially a symptom of inflation-creating a spiral of increased prices, for when the cost of transportation rises, such costs will eventually be passed down to other items.[10]

While society as a whole suffers from inflation, the most susceptible are those with fixed incomes, such as retirees living off Social Security or pensions. Even the cost of living increase afforded to retirees does not make up for their money becoming worthless, particularly since the cost of living increase is tied to the CPI inflation estimate which usually underestimates the true rate.[11] In addition, creditors-like landlords with long term leases or bondholders-are also hurt as the dollar loses value. Inflation erodes the life savings of retirees and has a dire effect on investments, making them much less valuable.[12]

Furthermore, inflation will worsen unemployment. As the dollar loses value, businesses will be unable to accurately gauge consumer demand or the cost of doing business, businesses and investors may even end up consuming their own original capital if they try to make long-term decisions. Such volatility will only make businesses more cautious in hiring and investing, preventing real capital from entering the marketplace.[13]

The only people helped by inflation are those in government as the decreasing value of the dollar makes it easier to pay-as well as incur-debt, for the money can be printed to pay for just about anything. Similarly, banks and other institutions who receive the money first are able to loan out the new money when it is worth more, and when they receive payments for these loans the money has depreciated, meaning the average citizen is effectively paying more as their money is worth less.[14]

The only way that the Fed can fulfill its dual mandate of lowering unemployment and stabilizing prices is for it to get out of the way and let the market work: allow interest rates to rise and tightly control the money supply. This was the formula used by Fed Chairman Paul Volcker to end stagflation in the early 1980s, and it could be used again to help us get out of our present mess.[15]

It is easy to become too focused on the popular topics of unemployment, taxes, regulations, and spending, but unless monetary policy is also addressed, inflation will ensure the recession continues for years to come.

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[2] Emily Knapp, "Bernanke Defends Fed Actions From GOP Attacks," February 2, 2012. Accessed April 25, 2012: http://wallstcheatsheet.com/stocks/bernanke-defends-

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[4] "Inflation formula Critics: 'Real' Rate Over 10%, Unemployment Tops 20%," April 20, 2012. Accessed April 25, 2012: http://www.moneynews.com/Economy/CPI-Conspiracy-inflation-economy/2012/04/19/id/436430.

[5] General Mills, "General Mills Reports Results for fiscal 2012 Third Quarter," March 21, 2012. Accessed April 25, 2012: http://phx.corporate-ir.net/phoenix.zhtml?c=74271&p=irol-newsArticle&ID=1674809&highlight=. General Mills trademarks a variety of food products, including Betty Crocker, Pillsbury, Green Giant, Nature Valley, Yoplait, Totines, Jeno's, Hamburger Helper, and Haagen Daz.

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[11] Social Security Administration, "Cost-Of-Living Adjustment." Accessed May 1, 2012: http://www.ssa.gov/cola/#tl0=Y.

[12] Murray Rothbard, *What Has Government Done to Our Money?* Fifth Edition, (Auburn, Alabama: Ludwig von Mises Institute, 2009), 53-54.A pdf of this essay may be viewed at http://mises.org/resources.aspx?Id=7184a3af-b7ff-4465-aab5-68a3c773b48b.

[13] Ibid., 54.

[14] Ludwig von Mises, "Inflation and You," from *Mercury*, July 1942. Accessed April 25, 2012: http://mises.org/efandi/ch18.asp.

[15] Michael G. Rukstad, "Paul Volcker and the Federal Reserve: 1979-1982," Harvard Business School, February 4, 2003. This paper may be viewed on pdf at www.nd.edu/~nmark/MonetarPolicy/Paul%20Volker.pdf.