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Inflation Game Redistributions and Economic Crisis Path

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Abstract. *Starting from the effects of the socially redistribution of wealth generated by inflation, the authors aim to identify the system of interests that supports this process, namely the connections with the economic crisis. In this aim, this work launches the hypothesis that the contagious disease of the market imbalances represents the basis for the manifestation of the inflationary process. By analyzing the assumptions and the causes of the market imbalances manifestation, the authors reveal a system of interest alliances that added to the complicit attitude of the consumers supports the manifestation of the inflationary process. The confrontation between this hypothesis and the inflationary trends in developed countries over the last four decades, respectively the recent lesson of the global economic crisis, leads to the confirmation of a common root of the inflationary phenomenon and the economic crises. The authors think that in order to avoid the emergence of new global economic crises and the negative effects of inflation, a radical behavioural change is required from both consumers and other economic agents.*

Keywords: inflationary game; economic crisis; consumerist behaviour; contagious disease.

JEL Codes: E20, E31.
REL Code: 8F.

Introduction

Generally, inflation is defined as a random increase in the general level of prices, with additional details regarding a specific period of time (Burda, 1997, Blanchard, 2000), respectively as an erosion of the purchasing power of money (Walgenbach, 1973).

Usually, the conceptualization of inflation calls for four major theoretical sources:

- The classic theory, represented by David Hume (1751), explains inflation in terms of price increases caused by the money supply increase.
- The Keynesian theory argues**,** through its very founder John Maynard Keynes (1936), that inflation occurs when the demand for goods and services is greater than the supply (thesis that, among others, was caught up by Richard Lipseys (1995), who proves that inflation has also extra monetary causes).
- The monetarist approach repeats David Hume's thesis arguing that *inflation is always and no matter where* ***a*** *monetary phenomenon* in spite of the fact that it makes valuable nuances between the temporal dimensions of the process: short term versus long term (Friedman, 1963).

Even in the inflation synthesis proposed by Frisch (1983), the characteristic elements fall within the same conceptual area described earlier:

- Inflation is generated by an excess demand, in other words, "too much money chasing too few goods";
- Inflation – an increase in the money or income reserve, on total or per capita;
- Inflation – an increase in the price level characterized by the following elements: if forecast with a certain degree of error, it leads (by means of costs) to new price increases, and it is measured by net prices (from which taxes have been deducted) and it is irreversible;
- Inflation – a depreciation of the value of money in relation to other currencies, measured by the exchange rate, or by the price of gold, or indicated by an excess of gold demand or other currencies.

The phenomenology of inflation

Beside nuances and controversies, the inflation conceptualization is based on the imbalance between money and goods, or in other words, between the macro market of all goods and the monetary market. It is thus necessary to conceptually sever the causes and the premises of the inflationary process**.** This is required in order to penetrate beyond appearances and to discern between

factors that can be influenced and modified by anti-inflationary policies and permanent, substratum factors that explain the persistence of the inflationary process even at low, controllable levels. Thus, one can say that the inflation assumptions are related to the very major imbalance on which economics is built: the disparity between the characteristics of needs and wants and those of resources and goods (Figure 1).

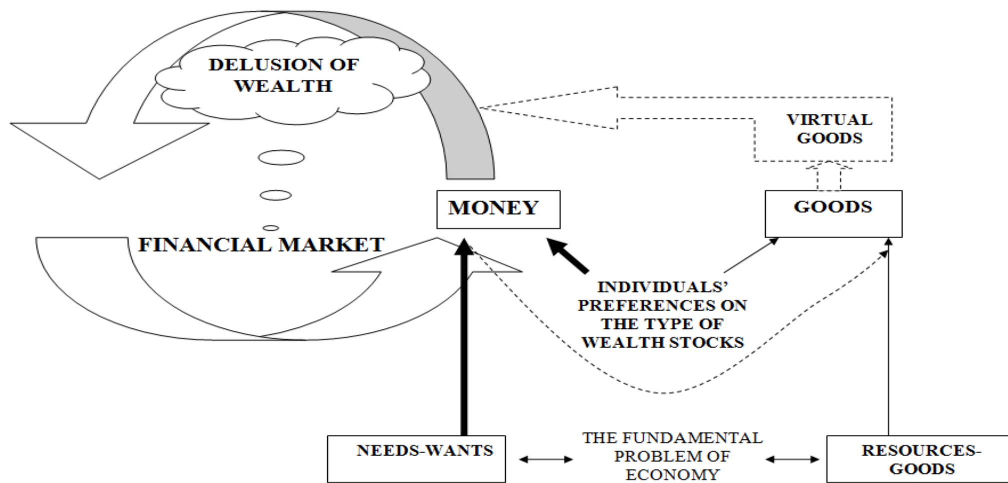

Figure 1. *The phenomenology of inflation*

It can be said that the main premise of inflation lies in the fundamental problem of economy: the identification of the ways to reduce the contradiction between the characteristics of needs-wants and those of resources-goods. Since needs and wants have a very strong dynamics and are virtually unlimited, there will be a much higher pressure on money as an indirect means (of access to goods) of solving the needs-wants binomial, than on goods that are produced much more difficult with limited resources.

Another premise, somewhat immediate to the inflationary process, is based on the individuals' preferences on the means of establishing the wealth stocks. There is no doubt that money will have net benefits in terms of administration, liquidity and mobility compared to goods. These two assumptions explain the predominance of the individuals' propensity to hold money in relation to the possibilities of production and the preferences for holding assets. Furthermore, the premises of inflation also explain the persistence of inflation beyond any mix of macroeconomic policies. This is due to the fact that the measures implemented by macroeconomic policies may affect the causes but not the premises of the inflationary process. For example,

the interest rate of the monetary policy will produce more expensive and more difficult to procure money, but it will not solve the fundamental problem of economy, that is slowing the rhythm of the needs-wants dynamics or a significant limitation of them. Moreover, this measure will only partially influence “the appetite” of individuals for money (even if they are more expensive) in relation to the stock of assets. In other words, the assumptions of inflation are related to the essence of economy, regardless of the time and space of its manifestation, while the causes of inflation are related to the materialization in specific forms of manifestation of this economic essence (national economies or world economy in certain periods of time). Thus, the monetary causes are related to the regulation of the broad money and its circuit in economy, the equilibrium of the exchange rate, the nature of the correlations between the monetary and financial phenomena, the equilibrium of the monetary flows in relation to foreign countries etc.

Moreover, money can support the monetary illusion of more valuable goods, a kind of delusion of wealth. In addition, the process of “value virtualization” (Dinu, 2011) in modern economies supports the illusion of an accelerated growth of material wealth through the emergence of virtual goods (securities, options, derivative instruments etc.). On the other hand, money is requested for itself (Keynes, 1936), i.e. in order to produce more money, entering the rotary delusion of wealth provided by the financial market.

The causes of the inflationary process arising from the real economy are related to the factors that determine the genesis and the dynamics of the aggregate supply and demand, to the national economic structure, to the labour market and productivity, to the emergence of competition and the efficient functionality of markets, to the connections that the national economic system has with the world economy etc. The correlation of the macroeconomic causes with the microeconomic causes of inflation may reveal hidden connections in the propagation of inflationary shocks. Thus, by insisting upon locating the causes of the outbreak and propagation of the inflationary phenomenon in the monetary market or the goods market, the fact that the roots of this macroeconomic phenomenon lie in macroeconomics is overlooked. In other words, inflation is observed and estimated at the macroeconomic level, but the onset of this imbalance occurs in the microeconomic markets. The neglect of the latter (microeconomics) leads to a virtual aberration of the inflation conceptualizing perspective by focusing it on the generalized increase of prices and the diminishing purchasing power of money, thus giving the impression that prices have the same increase (according to a specific index of prices). From this perspective, it becomes clear that inflation is a multidimensional phenomenon:

- The structural dimension dwells in the differentiated increase in prices in certain markets, and therefore their contribution in supporting the inflationary process is different;
- The spatial dimension is rendered by the distribution of the prices dynamics in the field, and their contribution to estimating the inflation level depends on the territorial structure of the observed price samples;
- The temporal dimension is rendered by differentiating the moments of time of the price increases onset, respectively by their temporal forms.

In order to observe these dimensions of the inflationary process and its microeconomic roots, it is necessary to avoid the "beaten path" in the scientific research. Thus, insisting on the fact that "inflation is *a generalized increase of prices and not an increase in the price of individual goods"* (Frisch, 1983) may be a form of *intellectual blindness* that would block the cognitive approach bypassing evidences like: *prices do not increase sharply, simultaneously and equally*; there are price increases that can lead to propagated effects (usually those of raw materials and energy products); the territorial manifestation and propagation of the price increases sends signals that are very useful in preventing the inflationary process etc.

Similarly, the microeconomic roots of the inflationary process could not be notified without considering the fact that the money – goods imbalance corresponds directly with the supply – demand imbalance that occurs in the real markets. The microeconomic perspective could support the hypothesis that inflation is a kind of *contagious disease* of the markets system. The process can be triggered by a shock that imbalances a market at some point. The contagious effect can trigger imbalances on vertical, horizontal or territorial integration structures. When the contagious effect becomes significant in terms of a structural dimension, the inflationary process occurs at a macroeconomic level. But, at that point, the anti-inflationary measures can be late and very expensive anyway.

In terms of the causes and premises of the inflationary phenomenon, to say that *human greed* is the basis of its manifestation does not suffice to notice how imbalances can occur in markets. However, in order to avoid gliding towards the historical aspects of the issue, we will limit the analysis to the modern times, namely to the emergence of marketing. According to specialists, marketing emerged because of the transition of the producer market to the consumer market(1) (due to the technological progress). This transition is reflected in the stage model of economic development created by W.W. Rostow (1960) through the highest level given to the *High mass consumption,* which is a stage of maturity, characterized by a thriving population and a mass production for sophisticated consumer goods. Rostow believes that this is a typical USA stage. This is the level of economic development at which the

slogan “the consumer is king” is promoted – a king that is continuously incited to an excessive consumption. Of course, the reason of this incitement is the profit maximization, but we are dealing with a real conspiracy in which producers, distributors and bankers become allies so that they can manipulate consumers. Profit increases do not arise only from the increased market shares, but rather from the economies of scale generated by a high mass consumption, respectively from the higher velocity of circulation of capital used by each of the protagonists of the alliance. Moreover, the contribution of the banker is very interesting for the purpose of our analysis because, by elongating the temporal dimension of the market, it provides the conditions needed for the economies of scale to function.

Thus, the possibilities of consumption financing are taken beyond the individual's current income, balancing revenues in an increasingly distant and uncertain future. It is no less true that the consumer also indulges in the delights of the abundance state, more often than not ignoring the problem of debt repayment. But from a monetary perspective, this consumption, based on the consumer’s complicity, leads to an increased velocity of money and hence, to an increased supply of money, according to Irwin Fisher's famous equation:

$$M \times V \uparrow = P \times Y.$$

Under these circumstances, the control of the monetary flows is shared between the central bank and economic agents, with the former controlling more often than not the broad money, while the latter are responsible for accelerating the velocity of money. This perspective is very useful from a conceptual point of view as it abolishes the accusation of the Austrian school, according to which the moral culprit for triggering the inflationary phenomenon is the state, that covers its inefficient production and distribution of public goods with money. Our approach does not rule out the causes related to the public sector inefficiency, but proves that the interests of the private sector can generate and sustain the inflationary process at a higher level**,** even when the central bank and the government apply a prudent monetary policy.

The ratification of the consumerist perspective on the outbreak and persistence of the inflationary process involves a confrontation with the macroeconomic limited approach of this process as an imbalance of the macro markets of all goods and monetary markets, respectively as a blockage of economic growth. Thus, as Figure 2 shows, the inflationary shocks have overlapped for an extended period of time with the shocks of economic recession which has favoured the tendency to explain the phenomenon of inflation by cyclical macroeconomic imbalances, respectively by accidental economic growths that occur in major developed countries.

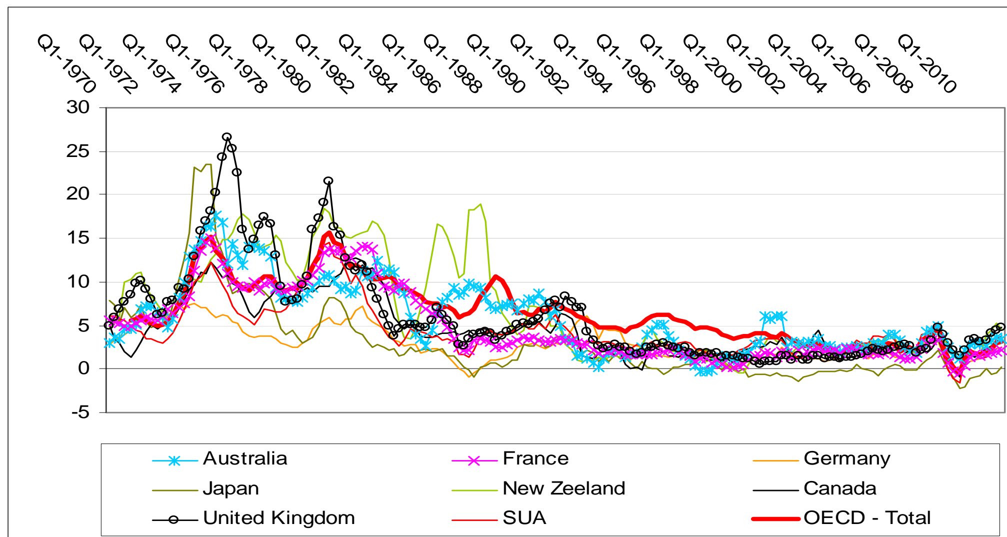

Figure 2. *Inflation in the major industrialized countries*

It may be tempting to address the relationship between economic growth and inflation as a structural feature of the global economy, but there are at least two reasons to resist this temptation:

- In a world of fluctuating exchange rates, there is an aim to adjust these rates in different countries in response to internal and external shocks.
- The period of global economic growth has been associated with an expansion of trade which reduced the cost of many industrial goods (processed) in particular.

As it can be seen in Figure 2, the trend of the structural relationship between global economic growth and inflation was abandoned as positive results acted in ensuring price stability rendered by the implementation of effective monetary policies, based especially on the inflation targeting strategy. The success of these policies was based on a series of fundamental reforms in production and labour markets in response to an increased competition due to the trade opening, which led to more flexible economies**.** In return, they become less likely to respond with inflationary pressures in case of cost or demand shocks. However, since there is little doubt that some economies are more flexible now than before, after all, there is no evidence that this should result in a lower inflation even though there may be many other beneficial effects of a higher flexibility.

Another possible explanation for the recent period of low inflation refers to good economic policies. OECD countries appear to have had somewhat

similar policies in the analysed period and hence the assumption that economic policies (in terms of interest rate policies of central banks) tended to move together. However, this observation tells us little about the phenomenon since the challenges that the economic policy makers were facing were similar as well. In addition, the explanation for the low inflation level in developed countries in recent years, based on good economic policies and structural reforms seems to overshadow the relationship inflation – recession/economic crisis and, therefore, our cognitive approach based on the interests system that supports the inflationary process. Indeed, statistics confirm that even during an ongoing economic crisis the level of inflation remained relatively low, which seems to support the opposing hypothesis that there is no conspiracy of interest in the generation and manifestation of the inflationary process.

Still, an increasingly number of economists believe that the recent financial crisis was not caused only by the excessively lax monetary policy of the Federal Reserve System of the United States**.** Thus, it becomes even more solid the opinion that the crisis was caused primarily by factors that had little to do with the monetary policy and that were largely due to the context created by the macroeconomic conditions, the distorted incentives on financial markets, the failures related to regulations and supervision of financial markets (even when central banks were responsible for regulation and supervision), the problems of information and certain specific circumstances**,** including the policy of the real estate market in the USA to support home ownership for mortgaged households with low income.[(2)]

The macroeconomic conditions that preceded the crisis have included both low real interest rates worldwide, associated with global imbalances and the period of moderation (The Great Moderation), characterized by stable economic growth and low inflation, which led to a systematic underestimation of the risks and the very low risk premiums in financial markets. There were some distorted incentives for commercial and investment banks to increase leverage, which was made possible by inadequate supervision and regulation, but also by the lack of an appropriate system of banking settlement. There have been distorted incentives both for exercising weaker requirements regarding the initiation of loans and the execution of regulatory arbitrage by creating off-balance sheet entities, which, for various specific reasons, ended up still in the balance. There have also been distorted incentives for traders and investment fund managers so that they take excessive risks because of the asymmetric remuneration contracts. Finally, there have been significant information problems regarding risk assessment for highly complex asset-backed securities. Concurrently, there has been an immense underestimation of the potential risks systematically correlated. None of these causes had anything to do with the

monetary policy, except for the fact that monetary policy may have contributed to the “Great Moderation”.

Succumbing to the temptation of the easy profit from trading commissions, many large banks were distracted from their basic functions: providing an efficient mechanism for payments, respectively assessing and managing risk and granting loans. The banking system in the USA and many other countries did not focus on providing loans to small and medium companies that are the basis of providing employment in economy, but rather they have focused on security, especially on the mortgage market. In a nutshell, financial markets have failed to fulfil their basic functions, leading to risks, allocating capital poorly, stimulating excessive debts, and imposing high costs of trade. Furthermore, rating agencies have given their blessing to what banks did. Financial markets have succeeded, based on innovation, to avoid regulations, as the tax and accounting rules have created products that were so complex that their effect was to increase both the risk and the information asymmetries.

This perspective reveals another conspiracy of interests motivated by profit maximization, which is similar to the consumerist hypothesis in support of the inflationary process. Thus, a new idea emerges, according to which the pressures of the interests system that supports the inflationary process have burst in an area of economy that is less supervised and regulated than that of the monetary policy objective of ensuring price (similar to a complicated system of communicating vessels circulated by steam pressure) – namely, the financial market. The idea could be supported by the empirical records that signal the emergence of some divergent trends in the dynamics of commodity prices and the average inflation rate in the world. Therefore the same system of interest alliances and the consumer’s complicity are the basis of the inflationary process and of the global economic crises, which proves that the two processes follow a mutual behaviour path.

In conclusion, we can assert that the solution to avoid global economic crises and the negative effects of inflation does not lie in improving monetary policy instruments**,** nor in correlating it with other macroeconomic policies, nor in complicated institutional constructions that supervise and ensure the stability of the financial market, but in a radical change of behaviour that first and foremost involves the consumer’s awakening**.** Only when the consumer is aware of the fact that letting himself be manipulated towards excessive consumption is detrimental in the process of inflationary redistribution of wealth, will the basis of a new economic alliance be laid, an alliance that is favourable to a sustainable development and an individual and social well-being.

Notes

(1) The producer market describes a state of relative scarcity of goods, as the producer holds the dominant position in relation to the consumer. On a consumer market**,** the balance of power changes due to the abundance provided by the technological progress and by the competition between producers, competition in which consumers are favoured.

(2) See Bean (2009) with a very elaborate analysis of the crisis, including the expanding credit and the housing boom, macroeconomic history, distorted incentives, information problems, amplification and propagation of the crisis in the real economy, policy responses and lessons about monetary policy and economy in general.

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