# INFLATION: A STRUCTURAL PROBLEM

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Inflation has become a structural problem. Prices have been rising in spite of government policies to curb inflation. The economy experienced a recession in 1969-70 with output falling and unemployment rising, yet prices continued to rise. The structural factors contributing to the persistence of inflation include, business concentration, labor power, expansion of government spending and waste in consumption.

The purposes of this paper are (a) to identify inflation as a structural problem, and (b) to present and discuss structural factors contributing to the persistence of inflation.

## INFLATION PROBLEM

Substantial yearly increase in price level has been taking place since the mid-1960's. Government economic policies since 1969 have been concentrated on slowing down inflation and all measures taken have failed. In 1969 and 1970 control of monetary policy was utilized and the economy went into recession with output falling and unemployment rising, yet prices continued to rise.

A price and wage control program was imposed from late 1971 to mid 1974 (1). Prices continued to rise at rates of 4.3 per cent, 8.7 per cent and 10 per cent in the years of 1971, 1972, and 1973 respectively. Unemployment rates remained above 5 percent during this period (2). After lifting price wage controls, monetary policies were utilized again. Unemployment rose to 6 per cent in October 1974. Output declined while prices continued to rise at a rate higher than 10 per cent in 1974.

## STRUCTURAL FACTORS

The existence of structural factors in the United States economy has contributed to inflation. Among the most important structural factors are: business concentration, labor power, expansion of government spending and waste in consumption.

### Business Concentration

Business concentration has been growing since World War II. The share of value added by manufacturing accounted for by the U. S. 200 largest manufacturing corporations rose from one-third to more than two-fifths. In periods of inflation large firms do not worry about losing a share of the market by raising prices. Increased prices by one firm will be shortly followed by an increase in prices of other firms. During inflation, the decision to increase the existing price is likely to be less elastic than during stable prices. The reason is that spending increases in period of inflation. Every firm is experiencing an increase in demand for its product, resulting in attempts to maintain quantity in face of rising prices. Even if quantities are not maintained, total receipts will not decline.

### Labor Power

During the 1960's, labor power grew dramatically. Labor in the 1960's and 1970's is highly skilled compared with labor in the 1940's and 1950's. It is hard for employers to replace employees or invest in training of others. When labor strikes, or threatens to strike, employers feel that an increase in wages is the best alternative, especially during inflation when both prices and profits are high and the firm can pass the increase to the consumer.

In 1971, a year of 5.7 per cent unemployment, wage increases were sizeable and there were 4,900 major walkouts. The average pay increase was about 40 cents per hour. This was 12 cents more than the increase in 1970, when there was a 4.9 per cent rate of unemployment. The heavily unionized industries obtained the largest increases, i.e., the construction workers got an increase of 68 cents per hour in 1970.

In the late 1960's and early 1970's, workers demanded not only a wage increase but a further increase to catch up with the cost of living. That cost of living adjustment was applied not only to unionized workers but spread also to all workers including government employees. When union workers are able to get a sizeable wage increase, other sectors will view this as a further justification for their increase. Thus, the spill over effect of a large union increase will be greater during a period of inflation.

When wage increases are not matched by a proportional productivity increase, it becomes inflationary. Low productivity increases are frequently found in the service sector where unionization grew rapidly in the 1960's, and especially in the government sector.

Unionization of the government sector was recognized by law in 1961 and since then the Union membership among the public employees has been increasing. The increase in public employee union membership was 150 per cent between 1960 and 1971. In the 1960's, the increase in Union membership in retail clerks, communication workers, and all miscellaneous service employees were 90%, 92% and 76% respectively. Not only unionization of the service sector has been increasing. The proportion of the labor force in the service sector has also increased throughout these years. This phenomena keeps productivity low and perpetuates inflation. In 1970, about 62.5 per cent of the total labor force were working in service industries, and this proportion is expected to continue to increase.

Wages have been increasing at a faster rate than the average yearly productivity increase of about 3 per cent. Between 1964 and 1970, weekly earnings in the service sector increased from an average of $70 to $98, an increase of 40 per cent. During the same period, manufacturing earnings went from $103 to $134, an increase of 31 per cent.

### Expanded Government Spending

Government spending has been increasing since the 1930's. Most of the Federal budget has been devoted to national defense. Military production is most inflationary, since it increases money in circulation and demand, while it does not contribute to production of consumer goods or services.

Total spending on national security constitutes about 65 per cent of federal funds. These expenditures include all of the Department of Defense budget plus expenditures on international affairs, space research and technology, veterans benefits, and interest on the national debt due to past wars. When these factors are included the defense budget continues to be high even after the end of the Vietnam War.

While the military sector is getting the largest share of the federal budget, sectors which could increase productivity and add to the total supply of consumers goods and services such as agriculture, natural resources, transportation, community development, and development of human resources, are in need for more funds.

A possible increase in productivity is being held down by lack of investment. In agriculture and rural development, an area where funds could be highly productive, the total federal spending was cut from $7.35 billion to $6.89 billion in 1973. The budget for natural resources and environment was cut nearly in half from $4.37 billion to $2.45 billion in 1973. The commerce and transportation budget was slightly reduced from $11.87 billion to $11.55 billion. Human resource funding was increased only slightly from $10.14 billion in 1972 to $11.28 billion in 1973. All of these cuts contribute to low productivity and high prices.

### Waste in Consumption

Demand is kept artifically high as consumers buy more than they need. Business and industry have encouraged waste in order to sell more at high prices. The sale of indivisible goods keeps consumer spending at a high level and encourages waste. Each family must have one or more automobiles, a number of household appliances, a large quantity of toys and may even own a swimming pool in their backyard. The number of cars is often equal to the number of adults in the family. Everyone drives a powerful, high gasoline consuming, car. High gasoline prices and repair costs contribute to high transportation costs.

The economy of mass production that depends on a continuous high demand has caused designers to make non-repairable small appliances. Those that cannot be repaired must be replaced, keeping consumer spending high. Other sources of waste in consumption contributing to high prices and increased spending are: widespread use of disposable products, disposable containers and fancy packaging. Many people make their income by inventing or creating new fancy designs not of the product itself but of the package or bottle which may not create a use of equal value. This type of enterprise contributes to low productivity.

Advertising keeps the demand at an artifically high level and in addition lowers its elasticity. Thus, larger quantities can be sold at higher prices. Having inelastic demand for a product makes it possible for producers to pass any increase in costs of production to consumers through higher prices, and makes it safe for the producers to grant their labor large wage increases without fear of lower profits. For this reason, advertising has become an important part of production costs, leading to higher prices.

In conclusion the structural factors that contribute to the persistence of inflation are part of the social, political, and economic system. These factors are unlikely to change or diminish, in the foreseeable future. Changing these structural factors requires something more than the traditional economic alterations of monetary and fiscal policies.

## REFERENCES


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