JE INFLACE DAŇ?

IS INFLATION A TAX?

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ABSTRAKT
Cílem tohoto příspěvku je odpovědět na otázku, zda je inflace daní. Otázka zní relativně jednoduše, avšak proces hledání odpovědi již tak přímý a jednoduchý není. Aby bylo možno určit, zda je inflace daní nebo ne, je třeba jasně a zřetelně definovat, co je to inflace, jaký je její účel, jak k inflaci dochází, kdo z ní profituje a tak dále, aby bylo možné posunout se v procesu hledání odpovědi dále. Toto však není tak jednoduché. Existuje řada ekonomických teorií týkajících se inflace, jejích příčin a forem náprav. Způsob, jakým je nazíráno na inflaci a vše jí se týkající, tedy i fakt, zda se jedná o daň, pak velice záleží na tom, kterou z ekonomických teorií člověk podporuje, nebo zda je schopen vymyslet a obhájit teorii svou vlastní teorii. Toto je jedno ze zásadních zjištění, které jsem v průběhu procesu shledala. Bohužel, z ekonomického úhlu pohledu opravdu velice záleží na teorii, té, která v očích posuzovatele nejvíce odpovídá realitě. I přes to však pevně věřím, že minimálně ve vlastních očích, se mi podařilo na tuto otázku odpovědět a to nejen z ekonomického úhlu pohledu.

ABSTRACT
The objective of the article is to present an evidence based answer to the question whether inflation is a tax. The question sounds reasonably simple but the process of answering the question is not so straight forward though. In order to be able to state if inflation is or is not a tax, it has to be clearly stated what inflation is, what the purpose of inflation is, how inflation happens, who gains from it and so on in order to be able to move on further. This is not so easy. There are many different economic theories on inflation, its causes and cures. How inflation is looked at and everything connected with it, that is for example the fact whether it is a tax or not, very much depends on which of these theories the viewers support or if they can think of, or establish their own theory and find evidence to support it. I have found out that much when trying to establish the grounds of the problem in order to be able to move on. Unfortunately from the economic point of view it does all very much depend on the theory that in your eyes most resembles the reality. Though having said that, in my own eyes, I believe that based on the evidence I at least in my own eyes have answered the question not just from the point of view of economics.

I. INTRODUCTION

I have often wondered about inflation. What actually inflation is, how it affects people, and if it is really necessary. Quite lately I have started thinking about inflation in connection with taxes. In the presented article, I have tried to establish whether or not inflation is a tax. So the objective of the research on which I based my article is to establish if inflation is a tax. I need to state that I am not a lawyer, I am an economist, but I have tried my best to see the situation from both points of view, though the economic point of view might be greater.

In order to be able to do so I looked at what inflation actually is and based on that tried to find out if it is or is not a tax. Before writing the article I myself was of the opinion that it is a form of tax so I might have been a bit biased when trying to find evidence supporting my opinion though I did my best to present a study that would not only ask the questions but also provide the answers for them.

The methods used were the method of description, comparison, analysis, synthesis and methods of conceptual research.

II. WHAT IS INFLATION

Quite naturally having decided to establish if there is a way in which inflation can be considered a tax, I need to start with figuring out what exactly inflation is. Now, that should be rather easy, one would have thought. A term which is so often used in the current political, economic and social climate, one surely needs to be able to know what one is talking about. Well as life itself, the simpler you think that something is going to be, perhaps not so surprisingly, the more difficult it surely turns out to be.

My conclusion based on the research that I have carried out, was that yes, it is quite easy to define inflation but it very much depends on what point of view you support. I have found out various approaches to inflation based on the way that inflation is defined. And that is when it got all a bit complicated. If there is not a unified version of the phenomena, how can we be able to do something about it? Keep it under control because it is so bad. How do we know which of the theories of the inflation phenomena is the correct one?

Yes, I must admit that on the one hand some of them seem to have more supporters than others. On the other hand, some of them seem to make more sense than others. But why is that so? Because they are the "correct" ones? If something has more supporters than something else, does it inevitably mean that I don't have to think about it? That I take it for granted? That that is the way it really is? But have those that consider themselves supporters of the theory really thought about it, took the time to consider if it makes sense? What if they just thought ok if he or she thinks that it must be true, surely he knows, I don't have to think about that any more. That would make my life so much easier. It almost seems silly to doubt.

Having briefly studied the history of economic thought, there was one conclusion I came to. Economics as a science is full of theories. Theories that are meant to describe the reality. There are theories that have more support, the main stream theories of the time periods and eras, but there are also those that have less support because quite often supporting them is not so economically beneficial. It does not mean that they make any less sense. Surprisingly or perhaps not so surprisingly rather often they make more sense. Common sense.

Well, my perception of what I have read got me thinking. My perception was that if we all are being told the same thing by the media, by the current top economists, by those who have the power to influence, then we all tend to believe that that is the way it is, that is the "correct way" to view things. Yes, and trying to look at things differently might be a bit scary, strangely not scary because it does not make sense, on contrary perhaps a bit scary because it all starts to make much more sense all together but it also leaves you in a position of a sort of an outcast because you do not any longer want to take for granted what you are being told, and yes, that can be a bit scary too.

Well, where does it leave us now? That is quite easy. We have to start at the very beginning. Let us have a look at various approaches establishing what inflation is and see which one makes the most sense.

1. The Four Economic Theories On Inflation[1]

Based on the definition available in the Encyclopaedia Britannica inflation in economics is collective increases in the supply of money, in money incomes or in prices. Inflation is generally thought of as an inordinate rise in the general level of prices.

From the theoretical point of view the above mentioned source states that there are at least four different schemata commonly used in considerations of inflation which can be distinguished.

Well, at least four. Does it mean that even more can be found? What are these four models and do they have anything in common?

The Quantity Theory

The oldest of the models describing inflation is the view that the level of prices is determined by the quantity of money. The theory goes as far back as David Hume in the 18th century but assumes that productive capacity is fully employed or nearly so. The extent to which the productive capacity is used varies in reality a great deal though therefor in a refined version Milton Friedman[2] stated that the short-period changes of the money supply are after a varying interval followed by changes in money income and that the velocity of circulation, tends to be fairly stable, especially over long periods. From this it was concluded that the money supply, while not a reliable instrument for controlling short-term movements in the economy, can be effective in controlling longer term movements of the price level and that the prescription for stable prices is to increase money supply regularly at a rate equal to that at which the economy is estimated to be expanding.

So as we can see, the link between money supply and inflation was established and the control of the money supply was supposed to gain control and from the current economic point of view it still is meant to control inflation. The European Central Bank shows and explains in one of their very user friendly materials how the inflation monster[3] is kept in a jar under control by the big and stable bank and it also introduces the term of deflation monster which is presented as just as dangerous as the inflation one. It also introduces the ways how the money supply can be controlled and in that way the inflation and deflation monsters can be kept on quite tight leashes. In other words the user friendly cartoon refers to the process of targeting inflation which is the way how to reach the goal and one of the points of existence of the European Central Bank and central banks around the world altogether. That is to keep price stability in the form of targeting inflation, keeping it within certain boundaries.

The Keynesian Theory

The second basic approach is represented by J.M.Keynes´s theory of income determination. The key is the assumption that consumers tend to spend a fixed proportion of any increases they receive in their incomes. Therefor for any level of national income there is a gap of a predictable size between income and consumption expenditure and to establish and maintain that level of national income it is only necessary to fix expenditure on all non-consumption goods and services to fill the gap.

The chief importance of the Keynesian approach and various elaborations of it is that they provide a framework in which governments can manage the level of activity in the economy by varying their own expenditures and receipts or by influencing the level of private invest-

[1] Compare with information available at http://www.britannica.com/EBchecked/topic/287700/inflation/3511/The-Keynesian-theory.

[2] and other economists of the University of Chicago in the 1950s and 1960s.

[3] For more information see http://www.ecb.europa.eu/ecb/educational/pricestab/html/index.en.html.

ment. Many economists believe that this approach has led to better control over short-term changes in employment and real income.

This theory does not offer much insight into movements of the price level. If for example government expenditure is higher than the difference between production and consumption, there is an inflationary gap. The market process closes this gap by pushing the prices up to the point at which the difference between income and consumption is big enough to accommodate the government expenditures.

At the core of Keynes´s economic view was the idea that government could smooth the volatility of free markets by expanding the supply of money and running large budget deficits when times were tough.[4]

So we can see quite a different approach to the whole inflation phenomena. The role of government and especially government expenditure is quite large in this theory though. It also seems to be the case that the government expenditure is a tool to fix a problem rather than a way of redistributing money and providing public goods. In my opinion this can lead to quite a misinterpretation of the role of government expenditure in the economy as a whole. I strongly believe that the increase of government expenditure should not be a way of starting up or supporting the growth of the economy, as in my eyes the government does not produce anything, it should only redistribute the wealth that has been produced by others.

The Cost-Push Theory

The third approach to the analysis of inflation assumes that prices of goods are basically determined by their costs, whereas supplies of money are responsible to demand. In these circumstances, increasing costs may create an inflationary pressure that becomes continuous. Money supply responds to demand, partly because monetary authorities do not wish to see the dislocation of capital markets that would follow if monetary deficiency produced very large rises in the rates of interest.

In my opinion, this sound more reasonable and more connected with real life. If we look at the prices of goods, yes, I think that we can quite naturally assume that their prices are primarily and to quite a large extent determined by their costs. Should these costs increase, the prices of goods have to increase too, as we can witness on daily bases. What makes the prices of inputs, the costs increase though? The assumption that money supply responds to demand is in my opinion primarily correct as well. On the other hand I believe that the role of the monetary authorities in the monetary market is quite crucial and in my opinion quite often leads to the destabilization of the monetary market rather than its stabilization. What I mean is that in my opinion the artificial control of interest rates leads to the dysfunction of the market. In the current economic climate, the interest rates are kept very low in order to make people spend money, make them consume and therefor again the idea of economic growth supported by the increase in consumption. The process of saving money is not beneficial. But it my eyes this is being done deliberately despite of what the market itself would do if left alone, that might lead to what was mentioned above about the attitude of monetary authorities towards large rises in interest rates.

The structural theory

The fourth approach to the inflationary process is not entirely independent of some of the above mentioned approaches. The main difference is that it puts emphasis on the structural maladjustment in the economy. One version of it depends upon the simple proposition that

[4] SCHIFF, Peter. *How and economy grows and why it crashes.* ,1. edition, U.S.A., New Jersey, Hoboken, Wiley and Sons, Inc. , 2010, 233pg. ISBN 978-0-470-52670-5, pg. 13.

resistance to reductions of money wages is so strong that they hardly ever take place leading to the fact that the rate of wage inflation as a whole is then seen as proportional to the rate of structural change in the economy.

Another version of the structural theory focuses on the gap between imports and exports. Alternatively inflation may result from social and political pressures to provide employment.

This version explaining the roots of inflation does not have many supporters but it seems to help explain the roots of inflation in developing countries.

2. A Fifth Theory?[5]

Imagine three men living on an island where there are no savings, no credit and no investment. In order to survive they have to catch and eat fish. Fortunately using their bare hands they could catch one fish a day which would keep them going. Not much of a life but everything that was produced was consumed. There was nothing to save, nothing to lend. One of the guys starts thinking. If only he could come up with something that would help him catch the fish quicker, he might then be able to catch more, save some etc. The next day he decides to go hungry and rather than spend the whole day fishing for one fish, he spends the whole day producing fishing net. He is taking a serious risk and he is also hungry. But, he makes it. He creates a fishing net.

A basic economic principle that can lead to an improvement in living standards is under consuming and taking risk.

By increasing his productivity he is now able to produce more than he consumes. From gains in productivity all other economic benefits flow. This spare production is the lifeblood of a healthy economy.

As a result of his willingness and ability to make loans the other two guys now have nets and their collective capacity to catch fish has doubled. This didn´t happen because the three guys were unsatisfied with their limited lifestyle. Their hunger, their demand, was necessary to start economic growth but not sufficient to achieve it. They were finally able to expand productivity to meet those demands. So it is the growth in productivity which leads to the growth in consumption.

The economy did not grow because they consumed more. They consumed more because the economy grew.

Most economists think that demand can be increased by giving people more money to spend. But that does not change real demand. Only by increasing supply can people actually get more of what they want.

Whenever an outside force, such as the government, encourages or demands that savers make loans for reasons that may have nothing to do with the actual likelihood of repayment, higher degrees of loss are almost inevitable. As a result of government incentives, the loans go to individuals of businesses that fail to pay them off then the loss falls to those individuals who have sacrificially under consumed to create savings.

Savings are not just a means to increase one´s ability to spend. They are an essential buffer that shields economies from the unexpected.

Falling prices do not hurt anybody. In fact, as prices for all things come down through similar productivity gains in other industries, the money you earn will allow you to buy more.

In my opinion these all are quite refreshing assumptions. Have you ever wondered how it is possible that the wages are always the same yet prices keep going up? Yet, not many people

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[5] SCHIFF, Peter. *How and economy grows and why it crashes.* ,1. edition, U.S.A., New Jersey, Hoboken, Wiley and Sons, Inc. , 2010, 233pg. ISBN 978-0-470-52670-5.

seem to be able to buy these goods. So how is it possible that the prices still keep growing? If you have a look at the supply and demand curves, surely the prices have to go down in order for the market to work?! So why is that not so?! Who and why does not allow the prices to go down?! Why is everybody scared of deflation? What is so wrong with deflation? Why do we always have to have inflation? It does not seem to make any sense. Yes, I have read the theories, yes, I have had it explained to me over and over why the central bank has to interfere not only against too high inflation but also against deflation. The theories are impressive, the numbers and charts also. They do back up all the theories. But what about the reality? What if the theories do not match the reality? In November last year, the Czech national bank intervened and in order to stop the decrease in inflation and spur the economy it changed the exchange rate to euros. The measured monthly inflation rate at the time was about 0,2% based on the statistics. When I looked at the number I could not believe my eyes. I thought that there must have been a mistake. When I calculated my very own inflation rate based on the change in my monthly shopping basket my number was very much different. I was currently experiencing an inflation rate of about 3%. The intervention of the Central bank hit me personally – just like lots of others – very hard.[6]

And that makes me ask two things. How is it possible that there is such a difference between theory and reality? And if that is so, what is the point of the various theories if they do not match the reality? The economic indicators are there to help us guide the economy. Inflation rate, GDP, average wages etc. How are they connected with everyday life though? The inflation rate the way it is being calculated does not quite match the actual rate of inflation, the average wage shows by how much the 75% of population that do not reach the limit is underpaid. Yet again, the theory and the reality. Quite often it seems like that those who set the current economic, political and social trends live in a very different reality to the rest of us.

Innovation is a one-way process. Unless people forget what they already know, efficiency always compounds. As a result, prices tend to come down over time. Steadily dropping prices also encourage savings.

There is no grater propaganda victory in economics today than the complete vilification of deflation and the relative acceptance of inflation. As far as economists and politicians are concerned, deflation, which is defined as the overall decline of prices over time, is the economic equivalent of the plague. At the slightest whiff of deflation, governments will typically enact policies to push the prices back up.

Modern economists mistakenly assume that spending drives growth and that when deflation is present people tend to defer purchases to allow prices to fall. And when they do spend the diminished price makes less of an economic impact. This is absurd. As it has been said before, it is not the spending. It is the production that counts. People do not need to be persuaded to spend. Given that human demand is essentially endless, if people do not want something there is likely a good reason for it. Either the product is no good or the consumer simply cannot afford to buy it. Either way, the act of deferring a purchase, or saving instead of spending, is made for rational reasons and tends to benefit the economy as a whole.

In fact, if consumers are not spending, the best way to spur demand is to allow prices to fall to more affordable levels.

Just as the principles of mathematics do not change with the size of the problem, basic economic principles do not change with the size of economy. They are just harder to see because of the many layers that exist between savers and borrowers. But the direct relationship

[6] For further information and comments on the actions of the Czech national bank se efor example http://www.penize.cz/kurzy-men/275793-oslabovani-pomylena-politika-cnb.

among self-sacrifice, savings, credit, investment, economic incentive and social and economic progress are always the same.

One of the reasons that economists have been so successful in obscuring the source of inflation is that they have short-circuited the very definition of the word. Nearly everybody believes that rising prices means inflation. So if prices aren´t rising, there must be no inflation. But rising prices are merely the result of inflation! Inflation is the expansion of the money supply. Any dictionary printed before 1990 defines inflation purely as an expansion of money supply.

During a recession people wisely stop spending. When they do, demand drops and prices should fall. But sometimes these forces are counterbalanced by an expanding money supply that diminishes the value of currency. When inflation is present in a recession, prices may go up (if the printing is fast enough), stay flat or fall less than they would have with no inflation. But during a recession prices need to fall in order to rebalance the economy. Recessions should be deflationary. Somehow modern economists see falling prices as a never-ending abyss toward demand destruction. They forget that when prices fall far enough, people start spending again. By keeping prices artificially high, inflation prevents this from happening.

Have you ever wondered where all this money comes from? How is it possible that there are all these financial rescue packages? Who has got the money? Why are they sending them somewhere where surely they will not see it again? Yes, I am talking about the Eurozone and the financial help to Greece etc. Sometimes the money just seems rather unreal, doesn't it? Almost like the money in banks? Is all my money really in my bank account? If I wanted to take it all out right now, would that be possible? What if everybody wanted to do that? Why can´t we all take all our money out at the same time? It is our money and we do pay for having it conveniently kept in the bank. So why not! Because it is not there? Where is it? What is the real value of the money then? Yes, and inflation gradually eats the non-existent money in my saving account away.

3. And more theories

John T.Harvey[7] seems rather determined to prove that the quantitative theory does not work and that it is not money growth that causes inflation. What is more he actually helps to understand what causes inflation and who gains from it[8].

The commonly used equation explaining the fact that money growth leads to inflation is that M being the money supply times V which is the velocity of money (or the average number of times each money note or coin is spent) equals P which is the average price of goods and services times y which is the total quantity of all goods and services sold during the time period in questions. Mathematically then MV=Py

As he says no economist disagrees with the basic equation. The arguments arise when additional assumptions are made regarding the nature of the individual variables. The money growth leads to inflation view assumes that M is easily defined and identified and only the central bank can affect its supply, which it can do with autonomy and precision. V is relatively constant. P assumes that the economy is so competitive that neither firms nor workers are free to change what they charge for their goods and services without there having been a

7 John T.HARVEY is a Professor of Economics at Texas Christian University, where he has been working since 1987. He specializes in the areas of international economics (particularly exchange rates), macroeconomics, history of economics and contemporary schools of thought.

8 HARVEY, John, T. *Money does not cause inflation!*[online]Forbes.com,14.5.2011[quoted 7.4.2014]. Available at http://www.forbes.com/sites/johntharvey/2011/05/14/money-growth-does-not-cause-inflation
HARVEY, John, T. *What actually causes inflation (and who gains from it)*[online]Forbes.com,30.5.2011[quoted7.4.2014].Available at http://www.forbes.com/sites/johntharvey/2011/05/30/what-actually -causes-infaltion

change in the underlying forces driving supply and demand in their market. The y is as large as it can be at any given moment as the economy automatically tends towards full employment.

Now, his arguments are the following. Take for example y. One need only look out of the window to see that it is not currently at the full-employment and therefor maximum level. Hence given the scenario where M.V=P.y there is no reason that this could not lead to the rise in y as those spending their so called excess money balances actually cause entrepreneurs to raise output to meet the new demand. This is of course the goal of the government deficit spending that so many economically-ignorant people are trying to stop.

Here I would like to point out the following. I have given the professor´s point of view a separate title, calling it the sixth theory. I am not sure whether it is correct as I believe that so far his suggestions support the Keynesian theory of spending our way out of the depression or recession though he is using it to demonstrate this fact the quantitative theory or rather trying to prove wrong the incorrect assumptions that are at the base of it. As to my feelings towards what has been said so far in his argument I myself would most certainly count myself among what he calls economically-ignorant person as I strongly disbelieve that the government should use deficit spending to kick start the economy or rather support the consumption in order to kick start the economy. The reason I say so is that I believe and support what Peter Schiff has stated in the earlier section of the article and that is the fact that it is not consumption that drives the economy. When I hear the words consumption and it is necessary to buy in order for the economy to grow it makes me very angry. When studying or teaching economics one of the first things that comes to light is the actual definition of the science. Economics that is the science about how to use the limited economic resources in order to fulfil the unlimited human needs or wishes or rather finding an optimal redistribution of those resources so to maximize the satisfaction of the maximal amount of people. When you look at the definition, the economic resources are no doubt limited, there is a limited amount of labour, capital and land at any given time. Economists argue that it is the unlimited human wishes that actually drive the economy, that it is the reason why we exist, why we carry out any economic activity. I am not sure here. I am not sure how much of this is human nature and how much of this is something that we have been taught throughout our lives. Always wanting and needing more does not sound very natural to me. On the other hand, without wanting more, without development, human kind would not be where we are now. Well, let´s assume that that is also a correct assumption. Ok. But what about the following. We have limited resources on one hand and unlimited wishes on another hand. And the most economical way of how to fulfil these needs and wishes is to keep consuming? Keep buying things, keep spending money? Surely it must be more economical if the product that we let´s assume willingly buy in order to satisfy our needs and wishes can provide the service or satisfaction as long as possible, isn't it? But if you look at most products these days, they are not designed to last. You need to replace them quite quickly whether you want to or not. You need to keep spending and consuming. And also, how long does the product satisfaction last? But how does that lead to the best use of the limited and precious economic resources? And I also believe that if the reality is to get better people will need to learn to distinguish between their needs and their wishes but also to use their common sense, something that it seems like we have forgotten that we all have. But I cannot see that happening, not in my lifetime anyway.

But back to John T. Harvey and his theories. In addition there is a great deal of evidence that the velocity of money is not constant. As one would expect it tends to decline in recession when people do, in fact, want to hold more cash.

I agree with this assumption one hundred percent. But I would also like to go a bit further. As it has been in my opinion quite rightly pointed out, in recession people try to hold to their money. Well, they have a reason for it, do they not? It is a form of security in such difficult times. In times of insecurity connected with the economy, with their job, with their life. It is only natural, it is instinctive and it is right. Surely it would be only natural to try to save money in order to have something in case there is a problem so that you can use this little safety net to help you come out clean. But what are the interest rates doing during these times? Saving is one thing that is discouraged! The interest rates are kept very low in order to stop people saving the little they can afford, they are encouraged to spend, to spend the way out of the hard times. Basically people are told by those who are supposed to be the experts that they need to spend the little they have in order for things to get better. And most of them do. Most of them go not only against their natural instincts, they go further, they borrow money. Not only they are told that there is nothing wrong about borrowing money for consumption they are told that that is what they should do, quite frankly they are encouraged to do that. And this is at the root of the problem. Why is it that way? Why are we not supported to save in times of recession? Because the prices would have to fall as they quite rightly should? Because it would be natural? Because if we had some money saved we could not only use it as a safety net we could also use it to invest into something, something that would help to start the economy in an efficient way?

Talking about the money supply (M) it is assumed that only the central bank can affect the amount of money supplied. As Harvy says the financial sector can create and destroy money without direct action by the central bank. Every time a loan is made the supply of money increases. The bank is creating money out of thin air, with only a fraction of the total necessary. Hence the private sector has a great deal of control over M.

I myself believe that this is where one of the major problems of the economies today lies. The fact that the money is not linked to any real value any more. Here I fully support the view of Edward W.Younkins[9] though yet again, I cannot see it happening no matter how beneficial and economically healthy it would be for the economy and people in my opinion.

Edward W.Younkins[10] defines inflation rather strongly and quite unorthodoxly as a dishonest and deliberate policy and tool of politicians who do not wish to reduce their spending. The government "creates" new money in order to cover what it spends in excess of its income. In reaction to that he asks for what he calls the real monetary reform. Traditionally, the gold standard was used to tie the value of money to something more constant and stable than the capricious desires of government officials. Such an impersonal protection is needed to restrain the actions of those who hold a legal monopoly on the creation of money. Under the gold standard, the quantity of the money supply is independent of the policies of government. Gold represents value uncontrolled by government. The gold standard takes decisions regarding the quantity of money out of the hands of politicians. The gold standard provides a market-based medium of exchange and a stable monetary system through which men can exchange and save the results of their labour. This monetary stability will force the government to abstain from monetary depreciation. Not only would the government have to stop inflating, it would also be forced to balance its budget and eliminate many wellfare programs. Under a gold standard, politicians cannot spend more unless they raise taxes. Under the gold standard, banks and individual would be able to make loans, but they would be limited to the amounts savers had accumulated and were making available for lending purposes. The gold standard´s requirement of fully convertible money would keep more than one claim to the same money from occurring.

9 Edward YOUNKINS is a Professor of Accountancy and Business Administration at Wheeling Jesuit University at West Virginia.

10 YOUNKINS, Edward, W. *How government manipulates money and produces inflation.*[online]Quebecoislibre.org, 28.10.2000[quoted 7.4.2014]. Available at http://www.quebecoislibre.org/001028-11.htm.

If we have a look and take time to understand how the process of lending money within the banking system works at the moment, the process of multiplication of the money does seem rather fishy and in simple terms does mean that the very same money has more than one claimant.

To continue with Harvey´s theory over the money supply or a theory supporting the monetary policies of the Fed[11] he claims that the central bank cannot produce money without the cooperation of the private sector. That the money supply grows only through the cooperation of the public sector as it is the public sector. The central bank cannot force a bank to accept a loan from the central bank and private banks cannot force customers to accept loans.

I must admit that this is in my opinion true. People are not forced to buy government bonds, they believe that it is profitable. They believe that they are going to earn some money due to this investment, and the banks are more than happy to accept cheap loans. The cheaper the better, it will be easier to sell on. But why is it? Can it be because we do not understand what is actually happening or is it because we do not care?

So to finish off the theory of John T.Harvey, he claims that the general assumption of the quantitative theory is correct that is MV=Py. But the definitions of the four components should that the money supply represented by M is elusive in a modern, credit-money economy and its value can change either with or without direct central bank intervention. In addition, the monetary authority cannot raise the supply of money without the cooperation of the private sector. Because central banks almost always target interest rates rather than the quantity of money, they tend to simply accommodate demands from banks. The central bank´s impact is indirect and heavily dependent on what the rest of the economy is willing to do. The velocity of money is what has been stated with one slight but rather important change and that is the fact that it is not constant even over the short term. As to the P, being the average price of goods and services, here he says not only that it can be the change in prices that lead to inflation, he claims that since it isn´t the change in money supply M, it has to be the change in price. As to the level of employment, well the economy does come to rest at less than full employment he states.

Therefor in Harvey´s theory it is the rising prices that lead to an increase in the supply of money and not the other way round. So it is not money growth that causes inflation but the rise in price level. Following that, he recognizes three basic causes of inflation, that being the market power (e.g. OPEC), a rise in demand relative to supply (so called demand pull inflation) and an asset market boom.

III. IS INFLATION A TAX?

Quite frankly, I myself believe that inflation is a type of tax. In my opinion it is a tax on holding money, tax on savings. I was quite surprised that I have managed to find a lot of those stating and arguing inflation is a hidden tax, that inflation is a regressive tax, that inflation is a way of taxing by the government or a term called inflation tax. So far so good. That is what some of the economists say. But, is there any legal ground for considering inflation a tax?

1. Inflation is a hidden tax

In his article Lawrence Wilson[12] states that[13] many people do not realize that inflation is with us and that it is an extremely destructive hidden tax, especially on the poor of all nations.

[11] Federal Reserve, the central bank of the United States of America.
[12] Lawrence WILSON, MD works for the Center For Development.
[13] WILSON, Lawrence. *Inflation, the hidden tax*.[online]Drlwilson.com,June 2012 [quoted 7.4.2014]. Available at http://www.drlwilson.com/Articles/INFLATION.htm

People believe that inflation is rising prices. That is not quite true. Inflation means that there is more money out there chasing the same amount of goods and services. As a result, the value of money is diluted. One result is higher prices. Since the money is diluted, it does not work as well and it takes more of it too buy things. Higher prices are just a way we express the fact that the diluted money of today does not buy as much. Inflation is actually an old, secret method of taxing the people without their knowledge. This may sound strange because no one talks about inflation as a tax. But when extra money is printed up and put into circulation, it costs the government very little. The only cost is that of printing. The government can then lavish the money on all their favourite projects without worrying about the people complaining, because the money seems to be free. However, it is not free. What it does is to slowly dilute the money that is in existence already. In this sense, inflation is a hidden tax or a way the government confiscates people´s real wealth. If the government gave its new printed money to each of us to spend, it would not be so bad. Then at least we would all have more of the diluted or less valuable money. This is indeed a sneaky way to tax people because it happens so slowly that few people see it, it is hidden, there are no tax forms to fill out or taxes added to your purchases or bills, people actually feel richer because often their salary and the price of their house goes up, in fact many actually have more money, but of course all that cash is worth less and last but not the least inflation does not require any new laws that people could debate and vote down. Thus it happens silently and secretly.

In his article Michael Snyder[14] starts with stating Ronald Regan once famously declaring that inflation is a tax, and comments that sadly most Americans did not really grasp what he was talking about. If the American people truly understood what inflation was doing to them, they would be screaming bloody murder about monetary policy. Inflation is an especially insidious tax because it is not just a tax on your income for one year. It is a continual tax on every single dollar that you own. As your money sits in the bank it is constantly losing value. Over time, the effects of inflation can be absolutely devastating. For example, if you put 100 dollars in the bank in 1970, those same dollars today would only have about 17 percent of the purchasing power that they did back then. In essence, you were hit by an 83 percent inflation tax and all you did was leave your money in the bank. So who is responsible for this? Well, the Federal Reserve controls monetary policy of the United States and the inflationary monetary policy that the Fed has gotten all of us accustomed to is taxing the daylight out of us. Most of us have been living in an inflationary environment for so long that we have come to accept it as normal. Most Americans believe that prices are supposed to just keep going up as time goes by. This is why many economists get upset when the Federal Reserve starts printing money like there is no tomorrow. Inflation is a tax that is very cruel on average American families. It destroys their wealth and it destroys the purchasing power of their pay checks. Unfortunately, this is always what happens when a society adopts fiat currency. Dollars are just pieces of paper backed by absolutely nothing. When more pieces of paper are printed up, the value of the pieces of paper already in existence goes down. This is one of the reasons why so many people out there are talking about real money like gold and silver. Unlike fiat currency, precious metals tend to hold value over a very long period of time. There is much more to all of this of course, but what is important for the man and the women on the street is the fact that when the Federal Reserve expands the money supply it is a tax on all of us and it makes all of us poorer.

[14] SNYDER, Michael. *Inflation is a hidden tax and the federal reserve is taking the living daylights out of us*.[online]Theeconomiccollapseblog.com, 29.2.2012 [quoted 7.4.2014]. Available at http://theeconomiccollapseblog.com/archives/inflation-is-a-tax-and-the -federal-reserve-is-taking-the-living-daylights-out-of-us.

Having presented these two points of view both in favour of considering inflation a hidden tax and both of them blaming the government and the central bank for creating this situation I feel it necessary to state that yet again, it very much depends on your own point of view on the situation. Previously I have presented arguments both supporting the role of the government and central bank in the creation of inflation as well as those who saw the role of the monetary policy and government as quite the opposite. One´s own point of view very much depends on what you believe is right, what you believe is the correct explanation. And I have also stated my own opinion on the matter. But how is it possible that there are so many different points of view and so many opinions not only at the cause but inevitably at the cure. And why does the reality hardly ever matches the theory created in order to understand the reality?

2. The inflation tax[15]

On his blog Greg Mankiw[16] talks about the inflation tax. He states that one of 10 students wonders if it is possible to defend inflation. Why is it such a bad thing for governments to rely more on the inflation tax? As long as it is applied within the context of an inflation-targeting Fed, all the negatives of inflation can be contained. That is as long as the Fed sets the target inflation rate and then uses open market techniques to bring inflation into line by taking into consideration the new money there will be no unexpected inflation and therefore no inflation cost. There are many advantages to the inflation tax including painless, free collection and progressivity, that is those with the most accumulated assets pay the most.

It is a provocative proposal. I do not know any economist who would endorse it. To explain why, let me make four points:

1. The inflation tax is not painless. There are various inefficiencies that inflation causes, even if it is steady and predictable.
2. The inflation tax is probably less progressive than one might at first think. It is not a tax on all assets but only on non-interest-bearing assets such as cash. The rich are able to keep most of their wealth in forms that can avoid the inflation tax.
3. The inflation tax would raise only a modest amount of revenue.
4. For reasons that are not fully understood, high inflation tends to be volatile inflation. A stable and predictable inflation seems possible as a matter of economic theory, but it is rarely if ever observed. If we take this empirical regularity as a constraint, then choosing high inflation entails choosing volatile inflation, which increases uncertainty.

These are the reasons most economists would be adverse to a proposal of steady let´s say 15% inflation. But has some economist done a detailed and convincing cost-benefit calculation, weighing all the pluses and minuses, to figure out the optimal inflation rate? Not to my knowledge.

Reading this has rather shocked me in a way that I got the impression that not only there actually really is such a thing as an inflation tax, so it really is a tax but also it is quite well known and calculated by the government, just a pity that the government cannot as yet quite rely on the income from this tax.

3. Taxing with inflation

Robert Schenk[17] states that deficit financing and inflation are other ways to hide taxes. In his eyes variations of these methods have a very ancient history. In the days before paper

[15] MANKIW, Gregory. *The inflation tax.*[online] Gregmankiw.blogspot.cz, 23.5.2006 [quoted 7.4.2014]. Available at http://gregmankiw.blogspot.cz/2006/05/inflation-tax.html.

[16] Gregory MANKIW is a professor and chairman of the economics department at Harvard University, USA.

[17] SCHENK, Robert. *Taxing with inflation.*[online]Ingrimayne.com, 28.2.2011[quoted 7.4.2014]. Available at http://ingrimayne.com/econ/optional/HideTaxes.html.

money, money was usually in the form of coins, generally gold or silver. Sometimes the government would collect as much of the previous issue of coins as possible, melt them down, add a generous portion of copper, and reissue them. The advantage to the ruler is obvious. Modern governments have more options than their predecessors did. Financial markets and banks allow them to borrow without debasing their money. Because resources are shifted to the public sector, someone bears the burden of the action. If the government borrows more, higher interest rates will crowd out someone who will not be able to pay higher rates. Because the government borrowing is only one of a great many factors that influence the level of interest rates, and because interest rates affect other variables such as people´s wealth, the price of bonds varies inversely with the level of interest rates, it is impossible to identify the precise individuals whose spending is curtailed by the government deficit.

He also explains that there is a temptation by modern governments to finance some spending by printing money and thus causing inflation. Most countries have a progressive income tax. With this system, inflation will push people into higher tax brackets. This means that the government can raise taxes by causing inflation, without ever formally acting to raise tax rates.

Well, in my opinion this brings us back to the question of the inflation tax, as discussed previously and it seems to clarify the process of how this tax works and also supporting the argument of Mankiw that perhaps the reason for this not being officially discussed or used as such is only the fact that there is no cost-beneficial evidence that would have calculated the appropriate rate of inflation that would lead to the required result, that is pre-calculated government income as a result of inflation or the inflation tax.

4. Legal grounds for inflation being a tax

Not being a lawyer I tried my best to understand the legal background of taxes generally in order to seem whether I could find a way in which inflation could be legally considered a tax. In order to learn more about the history of taxes and the difference between a tax and a fee I used the book Financial law[18].

Based on the history of the development of taxes it can be said that the title of the payment meaning whether it is called a tax, a fee or any other form of a charge plays only a secondary role. For the process of forming the state income it is essential to choose such tool that would bring sufficient income to the state and at the same time lead to the smallest resistance of those who have to pay it.[19]

Well, from what I have learnt and presented about inflation so far, I think that based on that it can be concluded that it is a tax. It may not be officially recognized as yet, but that is a secondary issues. Not only that inflation brings more money to the state budget, whether it is sufficient or not, that is quite arguable, it also gives advantage to the debtors and the biggest debtor, the one who benefits from it the most, is the state. In comparison with other types of taxes, the resistance to inflation is rather small in the way that it is not widely considered a tax imposed by the government.

IV. CONCLUSIONS

I decided that in order to be able to answer sufficiently to the question of whether inflation is or is not a tax, I needed to look a bit closer at inflation itself. I presented short versions of

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18 BAKEŠ, Milan. KARFÍKOVÁ, Marie, KOTÁB, Petr. MARKOVÁ, Hana. Finanční právo. 6.upravené vydání. C.H.Beck, 2012, 552 s. ISBN 978-80-7400-440-7.

19 BAKEŠ, Milan. KARFÍKOVÁ, Marie, KOTÁB, Petr. MARKOVÁ, Hana. Finanční právo. 6.upravené vydání. C.H.Beck, 2012, 552 s. ISBN 978-80-7400-440-7, pg. 88-93.

various theories on inflation, on the causes of it. Based on which of these theories you believe in the possible cure for inflation arises. But here is the catch. They are all quite different. The theories as well as the cures, are quite often rather the opposite. So which is the right one, which is the correct one? A lot of questions have arisen as a result, some of them I provided my own opinion on and therefor answered in my own eyes, some of them I left unanswered, left for you to think about. But for sure there is a lot to discuss further concerning not just inflation itself but definitely the legal point of inflation as a tax. But that I will have to leave for the lawyers to decide.

KEY WORDS
Inflation, economy, money supply, central bank, tax

KLÍČOVÁ SLOVA
Inflace, ekonomika, nabídka peněz, centrální banka, daň

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