

Social and Political Aspects of Inflation*

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The natural differentiation that occurs between the material situations of particular social and occupational groups is further exacerbated under the conditions of inflation, which is inevitably accompanied by redistributive effects. This redistribution affects both current incomes and accumulated consumption assets. As a result, changes take place not only in the proportion of household consumption financed out of current income, but also in terms of real consumption. In the category of “real consumption”, we include the used up, previously accumulated consumption assets during a given period, the value of transfers consumed, and the effects of production or service activities by the households themselves.¹

Unfortunately, there are few estimates of real consumption and its changing proportions in different social groups. One can conclude from fragmentary information, however, that differentiation between households in terms of financial status also increases under conditions of simultaneous price inflation and goods shortage.²

It is worth emphasizing here that repressed inflation also carries with it significant redistributive effects.³ But the mechanism of redistribution in this case is different from that in a hypothetical situation of completely open inflation.

The social consequences of inflation

The differentiation in material status which occurs against a background of inflation leads directly to some negative social consequences. This has been confirmed unambiguously by the results of public opinion polls in countries where such research is carried out systematically, including Yugoslavia, Poland, and Hungary. Indeed, the case of Poland demonstrates that the *basic source for antagonisms in society is differences in material status*. “Currently, two criteria account for social cleavages more than any others - material, i.e., property status, salaries, wages, and earnings; and political, i.e., power, position, political beliefs, party membership. Material criteria are cited by 61-76 percent of those surveyed with much greater emphasis (half the respondents answered with a “strong yes”) than for political determinants. . . . According to half of the respondents (49-58 percent), politics does not play an antagonistic role at all.”⁴

On the basis of these observations (and it should be stated that we are not speaking here of pathologies of the socialist economy, only of its basic features during the phase of reforming the system of management under the conditions of partly open and partly repressed inflation), it is possible to formulate the hypothesis that *the basic factor differentiating society is not one's relation to the means of production, but one's relation to the means of consumption*. This is also the area where we must look for potential threats to economic and

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sociopolitical stability.

Finally, while speaking of inflation, a phenomenon should be taken into account which I have elsewhere described as “*the paradox of a lower level of satisfaction of needs at a higher level of consumption.*”⁵ Even as consumption increases (although in recent years most socialist countries have experienced an obvious slowing-down of its growth rate), the subjective view of households is that “it is getting worse all the time. Leaving aside the fact that at high levels of inflation, a relatively larger segment of households notes an absolute decrease in consumption financed from current income,⁶ this conviction about the worsening of their own material situation is shared by those segments of the population whose real incomes have actually increased. This is because the gap has widened between their expectations (consumption aspirations) and the actual degree to which these expectations are satisfied. As long as the dissonance prevails, the people will insist that “it is getting worse”, while politicians, citing statistical data, will vainly attempt to persuade them that “it is getting better all the time”. The disparity of these points of view is also explained by the fact that the public judges its financial status first and foremost according to the condition of the currency, and this perceived status declines with each devaluation. Politicians, on the other hand, tend to ascribe greater importance to emerging trends in macroeconomic categories. This differentiated picture is present in Figure 1. Since 1983 there has been growth of the level of national income (Y), consumption (C), and investment (I). However, the purchasing power and the rate of exchange of money have been subject to a drastic decline.⁷

We have learned from observing public opinion over the last few years that, as the inflation rate goes up, the above-mentioned paradox operates more strongly. On the one hand, this is the result of greater redistributive effects, and on the other, it stems from the difference between subjective perceptions of the increase in the cost of living and official statistical measurements. The latter can significantly understate the real consumer price index and are more likely to do so at higher rates of inflation.⁸

Therefore, there is no reason to be surprised at the declining popular support for the idea of economic reform. In the opinion of many socio-occupational groups, inflation (or more precisely, its excessive level) is identified with the implementation of economic reform. There is some justification to this view. It is precisely in this sense *that inflation has over time been converted from being a tool for making the national economy more flexible and facilitating the introduction of indispensable adaptive processes and structural transformations, into being one of the fundamental barriers to successful implementation of economic reform.*

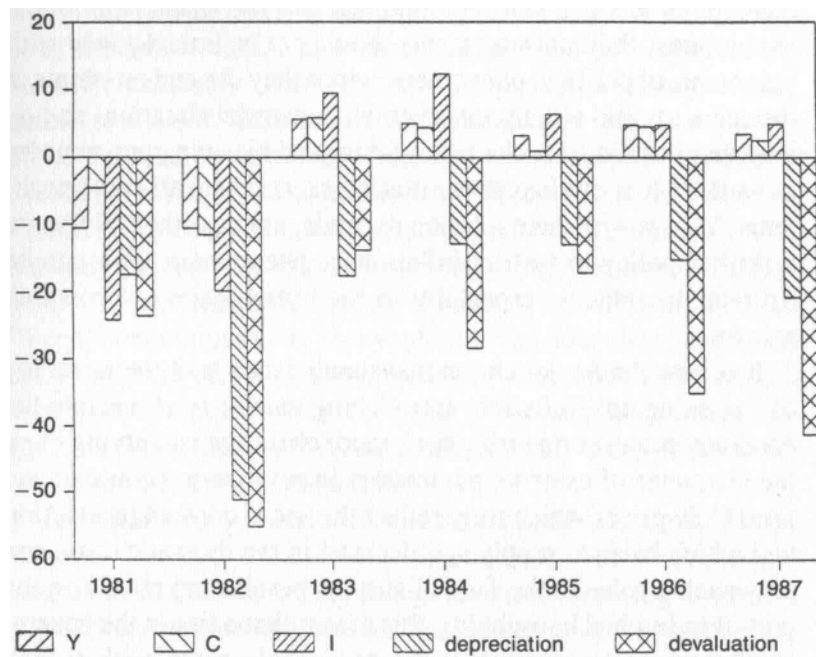


Figure 1. Economic growth and money (annual rates in %).

Political conditions and correlations

Stubborn and sometimes worsening economic difficulties and the sharp social contradictions that go along with them in the end also lead to growing political problems. This is also true in the case of the correlation between economic reforms and inflation. The results of the public opinion surveys cited above amply confirm this. "Dissatisfaction with one's material and economic position is carried over to relations with the political system and views of methods of government, and hardens into the shape of political convictions. Political statements should not be linked solely with judgments of political phenomena, since they depend on events in the economy and society, on a person's material situation, and on how that individual looks at the future and his own opportunities as well."⁹ It is obvious that inflation exacerbates all these problems. That is why their solution depends, among other things, on a skillful policy to restrict inflationary phenomena. This can be difficult to achieve, especially in the initial stage of economic reform.

It is now the Soviet Union that stands faced with the necessity of "opening up" inflation. Introducing market relations into the economy requires making prices more objective and giving them the character of external parameters in relation to economic actors. Only prices which truly reflect the social costs of production and which balance supply and demand in the dynamic sense can play such a role. In the face of surplus purchasing power on the part of individual households, this means that a rise in the general level of prices is necessary. In the traditional system, with its high degree of centralization, a decision to launch this kind of pricing operation would not always be transformed into an "inflationary shock" and did not always entail a cumulative escalation of inflation. Such was the case of Bulgaria in 1980, where an annual increase of 14 percent in the general price level was not followed by an inflationary spiral. The situation is reversed in the case of economies which have installed a market mechanism. Under conditions where the operating system is being reformed, price inflation cannot be avoided. The appropriate economic policy would be to control the rate of inflation. *As political tensions grow sharper, it is more difficult to carry out an effective policy against inflation, while at the same time such a policy is even more necessary.* Poland's experience during the 1980s speaks most eloquently in this regard.

Although its economic implications and consequences are fundamental, the employment question is also basically a political problem. It is hard to imagine how a regulated market mechanism would operate properly without an efficient labor market. Until now, the labor market has been insufficiently developed in the socialist economy. This clearly has pro-inflationary consequences, since it contributes to the chronically imbalanced state of the national economy, as expressed by the surplus of demand over supply. The political problem which faces socialist countries is the choice between continuing the policy of full employment (actually partial “excess employment”, i.e., hidden unemployment), which runs counter to efficiency, or allowing limited “open” unemployment. Many authors consider that the second option is more effective economically,¹⁰ while the social costs it entails are no greater than tolerating the consumer-goods shortages which accompany “excess employment”.¹¹ The two phenomena, after all, are interdependent.

The inflationary conditions that accompany economic reform not only intensify economic contradictions, but sociopolitical ones as well. One must fully recognize that attempting to resolve these contradictions through faulty methods or at the wrong time can only make them worse. Apparently the prevailing belief during this whole time was that essential political reforms, as manifested by the far-reaching democratization of public life, depended upon appropriate changes in the economic sphere. This approach is influenced by a continued belief that superstructural changes are contingent upon changes in the base.

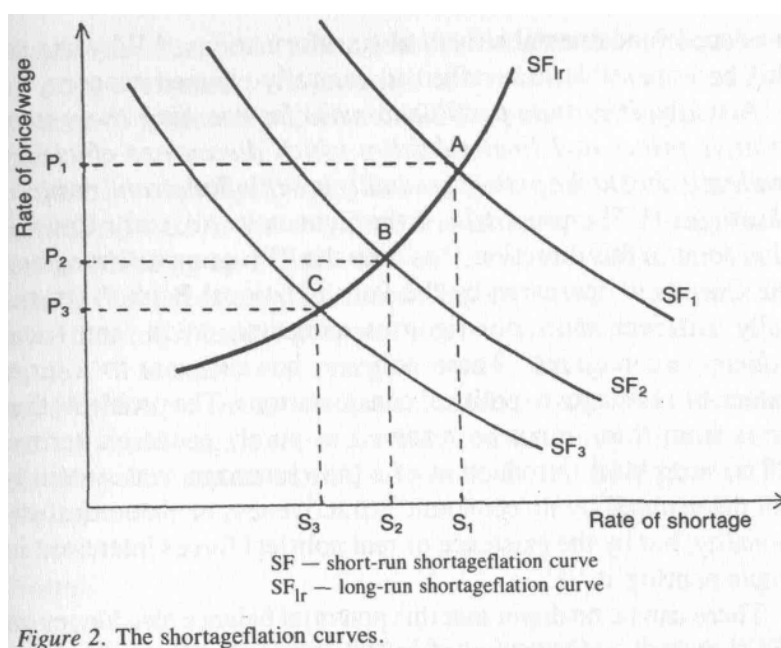
There are reasons to doubt this belief. Indeed, in some cases it seems reality shows just the reverse. *The further democratization of economic life requires democratization of the sociopolitical realm.* Without necessary institutional and systemic changes in the superstructure, it would be difficult to conduct a genuine policy encouraging efficiency through “hard financing” and “tight money” - and without this there is no way economic reforms can succeed. *One can hardly expect increased initiative from economic actors without a genuine restriction of the central authorities' political and economic powers.* Progress in this area has been totally inadequate in all the socialist countries. This should provoke little astonishment, since the assumption is still that the bureaucracy and the central government will limit their own powers. Such limitations, however, are indispensable if the reforms of the national economy's system of functioning are to succeed. Otherwise, the contradictions which occur in actuality between the interests of various socio-occupational groups, classes, and strata will spill over into the state-society dimension (state power). *The struggle over division of the national income under conditions of shortageflation is a perfect example of how contradictory interests can be thus transformed.*

Prospects for inflation and economic reform

In inflation some see an opportunity to quicken the pace of reform, others see a fundamental danger. I believe the second opinion is correct. That is why the necessary effort should be made to slowly bring down the level of joint open and repressed inflation. This should be done by moving along the inflation option curve, which illustrates the problem of choice in the short term between the rate of price inflation (open) or goods shortage (repressed), in the direction of further bridging the inflation gap by a general price increase rather than forced savings. At the the same time, there should be a shift downward of the curves lying closer to the intersection of the X and Y axes, i.e., a diminution of the inflation gap *ex ante* (Figure 2). This is a feasible procedure. All other variants which postulate renewed acceleration of the rate of price inflation should thus be rejected as ineffective. *Only actions which serve to reduce both the level of price inflation and the scale of shortages should be considered for economic policy.* Of course, this refers to the socialist economies

undergoing reform that are already entangled in shortageflation.

This does not mean that one should lapse into the kind of “antisubsidy euphoria” which in Poland threatens to dominate policy on wages and prices during the “second stage” of economic reform. It is interesting that this opportunity is being used to air the same arguments that were heard before the price reform back in 1982. As it turns out, however, after a nearly five-fold increase in prices during the last six years (1982-1987), price proportions are no better, and the relations of wages and other earnings are even less favorable than before the operation. The latest upward bound in prices has not only been difficult to implement for political reasons, but is also unnecessary from the economic point of view. The key to successful reform is not removing subsidies; it is achieving economic equilibrium. Wage and price policy and the economic and financial instruments used to carry it out should be subordinated to this goal. *It is much easier to reach equilibrium by lowering the inflation rate (for prices and wages) than by increasing it.*¹² What is required is a reasonable, parallel decline in the monetary income rates of all economic actors and, furthermore, adjustment of the money supply’s growth rate to the change in national income in real terms. It is astonishing that some people believe that double-digit inflation (with a more-or-less equivalent rise in wages) is practically the same as a wage and price freeze. Similar levels of inflation in the capitalist countries have produced fundamental structural transformations.¹³ Why should this be impossible in a reformed centrally-planned economy?



Actually, it is quite possible to make far-reaching changes in relative prices and limit subsidies which discourage efficiency while sticking to the path of gradually lower inflation and reduced shortages.¹⁴ The proposals of the Economic Advisory Council also point in this direction,¹⁵ as does the “Program to Strengthen the Currency” prepared by the Polish National Bank.¹⁶ Drastically different and more rigorous monetary, credit, and fiscal policies are required. These policies, however, are to a large extent still hostages to political considerations. The problems that arise from this cannot be resolved in purely economic terms. “The successful introduction of a [new] management system is not determined by its economic attractiveness or theoretical rationality, but by the existence of real political forces interested in implementing it”.¹⁷

There can be no doubt that this potential balance also hinges on the character and intensity of inflationary processes.

It should also be emphasized that in many cases there is little need to drastically cut back subsidies and thereby stoke up inflation. This is particularly true in the case of goods with a very low price elasticity (e.g., mass transit, central heating - since there is a shortage of thermostats on the market - etc.) or goods whose consumption we seek to encourage (e.g., milk and dairy products). It should be remembered that getting people to save, for example on their use of hot water or trips on mass transit, requires either suitable technical conditions or a real alternative. Lacking either, there will be no savings because the demand is inelastic and, because of the significance of expenditures on such items in household budgets, there will probably have to be full recompensation for the increased purchase price. This only serves to promote inflation. It is one thing to recognize that the existing system of public grants and subsidies is overgrown, but there is no point in going to the other extreme.¹⁸

To date, reforming the socialist economy has not been an encouraging experience. Particularly disturbing here is the trend toward stagnation displayed in recent years by the Hungarian and Yugoslavian economies, the unresolved structural problems, lack of competitiveness on international markets with attendant balance-of-payments problems, and the very high rate of inflation.

On the other hand, there is an objective need to carry out radical reforms of the way the socialist economic system functions, including such collective bodies as the CMEA.¹⁹ These reforms are necessary if imminent challenges to development are to be met and if further progress as a modern civilization is to be made.²⁰ It is worth cautioning, however, that achieving market equilibrium, activating the capital market, expanding the labor market, and bringing about currency convertibility will not solve all our social and economic problems. It will only give us the chance.

Notes

1. Cf. M. Pohorille, *Potrzeby, podzial, konsumpcja*, Warsaw: PWE, 1985.
2. B. Tylec, "Konsumpcja realna gospodarstw domowych," in M. Pohorille, ed., *Tendencje rozwoju konsumpcji. Postulaty i uwarunkowania*, Warsaw: PWE, 1982; M. Oles, M. Sumlinski, "Oszczednosci a rozmiary i struktura majatku gospodarstw domowych," Warsaw: Instytut Finansow, 1987 (mimeographed typescript).
3. Cf. G. W. Kolodko, *Polska w swiecie inflacji*, Warsaw: KiW, 1987.
4. S. Kwiatkowski, „Co Polakow dzieli?” *Polityka*, 1987, no. 28.
5. Cf. G. W. Kolodko, *Cele rozwoju a makroproporcje gospodarcze*, Warsaw: PWN, 1986.
6. The estimate can be made that at the levels of inflation we have observed in Poland over the last five years, in the case of approximately 50 percent of total households we are dealing with a drop in their real level of income, despite the fact that these incomes, on average, are rising (more than 2 percent annually). When referring to indicators of change in real incomes, I mean their statistical expression. Such statistical measures lose meaning, however, in conditions of severe disequilibrium.
7. Cf. G. W. Kolodko, A. Szablewski, "Pieniadz - gospodarka - spoleczenstwo," *Wektory*, 1987, nos. 5-6.
8. Cf. I. Adirim, *Stagflation in the USSR*, Falls Church, Va.: Delphic, 1983; J. Winiecki, *Zrodla inflacji w gospodarce rynkowej i w gospodarce planowej*, Warsaw: PWN, 1986.
9. S. Kwiatkowski, „Co Polakow dzieli?”, ed. cit. 10. N. Shmelev, “Avansy i dolgi”, *Novy mir*, 1987, no. 6. [See English translation in *Problems of Economics*, vol. 30, no. 10 (February 1988)-Ed.]
11. G. W. Kolodko, W. W. McMahon, "Stagflation and Shortageflation: A Comparative Approach", *Kyklos*, vol. 40 (1987), no. 2.
12. In the Polish economy, given its economic structure and political balance of power, rising prices generate such strong pressure for corresponding increases in the population's wages and other monetary income that

- they perpetuate the existing imbalance. Cf. W. Charemza, M. Gronicki, *Ekonometryczny model nierównowagi gospodarczej Polski*, Warsaw: PWN, 1985.
13. For instance, over the past 35 years the inflation rates in Switzerland and West Germany have never exceeded 7 percent. Likewise, double-digit inflation in the developed capitalist countries must be considered the exception.
 14. Cf. G. W. Kolodko, „Na jaka inflację jesteśmy skazani,” *Zycie gospodarcze*, 1985, no. 33. A different point of view is presented by K. Lutostanski, „Jakie tempo zakłada?” *Zycie gospodarcze*, 1985, no. 38, and by M. Mieszczankowski, „O inflacji”, *Zycie gospodarcze*, 1985, no. 49. These authors suggest that inflation can basically be characterized as cost-related, which already predetermines its relatively high rate. But one should remember that roughly 80 percent of increased costs in an economy with a structure similar to Poland’s or Hungary’s are accounted for by growth in wages. (Cf. T. Erdos, “Causes of Inflation and the Outline of Stabilization Policy for Hungary”, a paper presented at the conference, “Balancing problems in conditions of economic reform”, INE PAN, Warsaw, May 19-21, 1987, mimeographed typescript.) The inflationary spiral mechanism influences growth of the general price level to a similar degree. See „Problemy równowagi pieniężno-rynkowej w latach 1986-1990”, Instytut Gospodarki Narodowej, *Raporty*, 1986, no. 26, p. 986.
 15. Cf. „Droga do równowagi (cz II)”, *Zycie gospodarcze*, 1987, no. 43.
 16. Cf. „Program umacniania pieniądza”, *Bank i kredyt*, 1987, nos. It-12.
 17. M. Gorski, G. Jedrzejczak, *Równowaga i stabilność w gospodarce socjalistycznej*, Warsaw: PWN, 1987, p. 43.
 18. On this matter, K. E. Boulding observes: “The growing conviction that public subsidies are inefficient poses a serious danger to society, because it destroys morale, self-confidence, a vision of the future, and society’s faith in its ability to manage its own affairs”. K.E. Boulding, “Pathologies of the Public Grants Economy”, in *The Grants Economy and Collective Consumption*, London: Macmillan, 1982, p. 3.
 19. Cf. L. Csaba, “CMEA Countries and East-West Trade”, *Comparative Economic Studies*, vol. 28 (1986), no. 3.
 20. Janos Kornai confesses to feelings of ambivalence when asking whether it is possible to push the process of reforming the socialist economy farther than Hungary has to date. “As a Hungarian citizen, I honestly hope that the answer.... will be affirmative. As a sometime advisor, I can try to help the process along in the right direction. As a scientist, I reserve the privilege of doubt”. Cf. J. Kornai, “The Hungarian Reform Process: Visions, Hopes, and Reality”, *Journal of Economic Literature*, vol. 24 (1986), no. 4.