UNDERSTANDING WHAT IS INFLATION TO CONTROL IT

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In modern economics, inflation is defined by various ways due to different views, so to curb and use it is also not the same. Therefore how is inflation well understood? The most impartial and precise are facts, so the best way is to concern our country and others' circumstances, at the same time inflation should be examined through its long history in the dialectic view.

In spite of different implications but there are only two basic definitions:

- Inflation is an event of money surplus in circulation causing a typical rise in goods and services. Supporters of this definition are Karl Marx, Irving Fisher, Milton Friedman...the two latters are neo-monetarists.

- Inflation is a rise in the general level of prices and costs. Those supporting this definition include Paul A. Samuelson, David Begg and Rudiger Dornbusch. Mr. Samuelson considered him as a person of common trend.

Other definitions often tend to follow one of two above definitions or use additionally the remaining idea for clearer meaning, for example, rise in the general price level due to depreciated money.

The two definitions is initially similar so they both were used in a seminar. But they are fully different in theory.

- The first definition attributes inflation to monetary phenomenon and use law of money circulation to explain and control inflation.

- The second one attributes inflation to price phenomenon, thus names it price inflation. It takes scientific doubts and conflicts such as accepting gold inflation through inflation statistics in the history of price inflation including the period of using gold coinage in the sixteenth century when prices in Europe rose four to six times. I wrote an article "What is price inflation?" (1) to analyze this definition, but recently this definition has appeared in the textbook *Macroeconomics* approved by the Ministry of Education and Training for economic universities and colleges (2). I think this definition may make students misunderstand its correctness and slant the task of macroeconomic management that cannot control money and serve the national economic development, so I would like to discuss this issue more.

The definition of price inflation in the above-mentioned *Macroeconomics* textbook is: "Inflation exists when the general level of prices changes. When the level of prices increases, it is called inflation, when the price level decreases, it is called deflation. So inflation is a continuous rise in the average level of price over time.(2)

In my opinion, this definition has some defects:

(1). Not clear, not seeing the nature but only phenomenon.

(2). Mistaking gold or siver coinage which have intrinsic value for token money which have extrinsic value.

(3). Not seeing the law of affecting inflation to control inflation.

I like to present each of my viewpoints:

1. This definition is not clear in *"when the general level of prices changes"* because change in prices means increase or decrease. This is thus the same definition for both inflation and deflation. It also contradicts the next sentence *"when the level of prices decreases, it is called deflation"*. The general level of prices changes because of following reasons:

- Aggregate supply far exceeds aggregate demand in recessions or extremely in economic crises. In those periods, business people must lower prices dramatically so the general level of prises decreases.

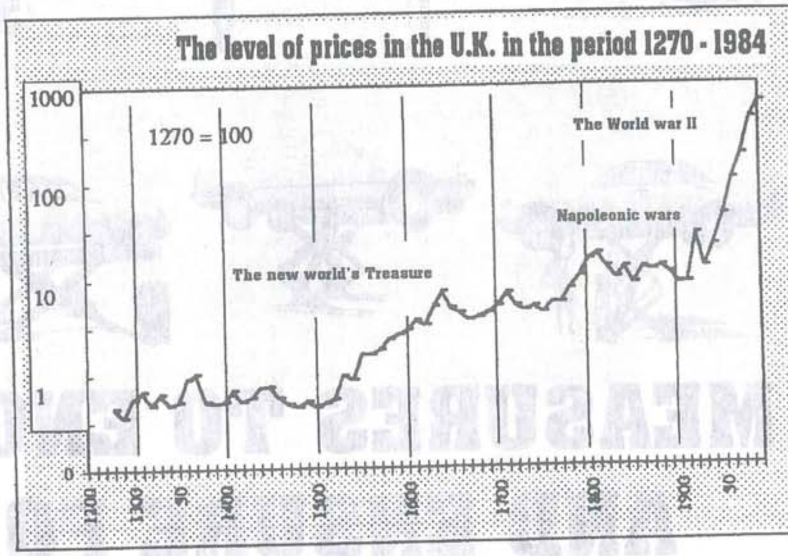
- Crisis of materials, for instance, in the 1970s, the oil war caused prices of oil to rocket four times, this raised the general level of prices in industrial countries and it was considered as "cost-push inflation" by the school of common trend.

- Speculation in essential materials generates a sharp rise in their prices which have strong effect on the general price index, for example, speculation in cement in Vietnam in 1995 made cement price shoot up from VNĐ55,000 to VNĐ88,000 per 50-kg package or by 45%. As a result, prices of building materials rose by 18.8% and general price index up by 1.8% in May while it was 0.8% and 0% in June and July respectively.

Combining these above reasons in price inflation is the same as considering fever as a kind of illness, consequently, using the temperature reducing medicine for all fevers regardless of their causes such as tuberculosis, typhoid and so on. When we introduce such a comparison, students will understand this definition sees only a rise in price index, not the inflation nature. This is a narrow view which leads to misusing remedy for inflation such as tight-money policy increasing high interest rates and selling bonds to the open market...with a wild hope to deal with speculation in cement as in 1995, avoid the impact of sharp increase in the world prices of rubber, coffee on our general price index. The Government did not make such a mistake, so it criticized the director general of the Vietnam Cement Corporation and set up a mechanism to prevent speculation in goods for increasing prices. The U.S. President did not use this concept of price inflation, so he instructed Mr McNamara, the Defense Minister to reduce aluminum price. Mr McNamara phoned John Harper to discuss the sale of the Pentagon's reserved aluminum and nullified the embryonic idea of speculation in alluminum of great capitalists.(3)

Regarding gold inflation in the sixteenth century, it was attributed to so much import of gold. In fact, the general level of prices went up due to a rise in productivity of exploiting gold when many gold mines were discovered and easily exploited in America and Africa, along with the gold robbing of American Indians. Depreciated gold led to such a rise in price index. Afterwards, the level of general prices never repeated a great change in the history. From this event, the theory "the general prices of a country depend on the amount of gold this country has" took shape. According to this theory, India would be a country having the highest inflation rate since its people hoarded the largest amount of gold in the world. But this was not recorded in the IMF's statistics.

2. Confusion of gold and silver coinage with intrinsic value and token money without intrinsic value is best indicated on the following figure:(4)



The level of prices in the U.K. in the period 1270 - 1984

The period of the new world's treasure has recorded the price inflation or gold inflation in Europe in the sixteenth century; it also accepted inflation in the gold standard period during which banknotes could be exchanged for gold coins at the start of the nineteenth century. Meanwhile every country wishing to have inflation for expenditures in the civil war or the World War I used laws to abolish the gold standard and applied compulsory use of banknotes. Even an ordinary person could not believe in gold inflation because there were no gold making machine. The science had no way to prove gold inflation because if any, it had to be proved the compulsory use of banknotes was not necessary when the government liked to have inflation for its expenditures in the war. There were also no practical tests for gold inflation.

The definition "price inflation" denies the fact that in inflation, only prices measured by token money increase simultaneously, but prices measured by gold show a small change according to supply-demand law. In the years from 1985 to 1988 in Vietnam, the price of a Honda motorbike rose tens times but its price measured by gold fluctuated around 1.5 taels of gold (1 tael = 37.5g). Do the authors regard prices measured by gold as virtual ones? This is a fact in every country. Can the authors find a concurrent rise in both prices measured by gold and ones by token money already depreciated in a country's inflation?

Perhaps they find no way to prove their argument, the authors supporting the theory "price inflation" with the second definition avoided the exchange of views on magazines when my article "What Is Price Inflation?" issued on the *Cộng Sản* (Communism) magazine in August 1991. I suggest the authors supporting the definition "Inflation is a rise in the general level of prices and costs" to argue on magazines in a straighforward and honest manner with a view to building a theory on socialist market economics■

1. Vũ Ngọc Nhung, *Những vấn đề tiền tệ và Ngân hàng* (Monetary and Banking Issues), HCMC Publisher 1998, pp 84.

2. *Kinh tế học vĩ mô* (Macroeconomics) by Prof. Dr. Vũ Đình Bách. Giáo Dục Publisher, Hà Nội 1997, pp 176.

3. Robert S. McNamara, *Nhìn lại quá khứ* (Looking Back upon the Past) - Vietnamese version, Chính Trị Quốc Gia Publisher, Hà Nội 1995, pp 110

4.P.A.Samuelson, Economics - Vietnamese version, Viện Quan Hệ Quốc Tế (Institute of Foreign Relations), 1989, pp.283.