Forum: GA2

Issue: The question of global inflation and its impact on the world's poorest population

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Introduction

Inflation is defined as the general increase in the prices of goods and services over a prolonged period of time, which has the effect of reducing the value of money and, by extension, its purchasing power, as each unit of money (eg €) buys fewer goods and services. A necessary condition for the existence of inflation is the change in prices. Its calculation results from the percentage (%) change in the consumer price index (CPI) over time.

The consumer price index (CPI) or price index is a measure of the cost of living and living based on changes in the retail prices of most goods or services. It measures the variation in prices of the goods and services included in the consumer's "basket".

From many economic theories inflation is considered a Monetary Phenomenon, meaning that inflation is the result of only an increased money supply. Thus, the existence of inflation does not affect the figures of the real economy (as real figures, Public Expenditures, Private Investments, and Private Consumption are defined).

Other theories find that inflation can have roots in non-monetary phenomena as well. Keynesian economists, for example, believe that there are frictions in the economy that can cause inflation. For Keynesians there is an inverse relationship between unemployment and inflation, so that when one rises the other falls. When inflation increases unemployment decreases and vice versa. Sometimes this relationship may not be proportional but the two phenomena proceed in the same way.

Definition of Key Terms

Imperialism

Imperialism is a state policy, practice, or advocacy of extending power and dominion, especially by direct territorial acquisition or by gaining political and economic control of other areas. Because it always involves the use of power, whether military or economic or some subtler form, imperialism has often been considered morally reprehensible, and the term is frequently employed in international propaganda to denounce and discredit an opponent's foreign policy.

Emerging market economy

An emerging market economy refers to a country that is in the process of developing its economy to become more advanced. It generates low to middle per capita income and is rapidly expanding due to high production levels and significant industrialization. Emerging market economies make up 80% of the world's population and almost 70% of the world's GDP growth.

Poverty

Poverty is the state of one who lacks a usual or socially acceptable amount of money or material possessions. Poverty is said to exist when people lack the means to satisfy their basic needs.

Progressive tax

Progressive tax is the tax that imposes a larger burden (relative to resources) on those who are richer.

Regressive tax

A Regressive tax is a tax that imposes a lesser burden on the wealthy.

Fiscal policy

Fiscal policy refers to the use of government spending and tax policies to influence economic conditions, especially macroeconomic conditions. These include aggregate demand for goods and services, employment, inflation, and economic growth.

Monetary policy

Monetary policy is a set of tools used by a nation's central bank to control the overall money supply and promote economic growth and employ strategies such as revising interest rates and changing bank reserve requirements.

Disinflation

Disinflation is when the rate of inflation decreases, usually in the short term. Prices are still rising, but at a slower rate. Disinflation happens for a variety of reasons including decreases in demand, stricter monetary policy from a central bank, or increases in productivity. Disinflation is not the same as deflation, which is a sustained decrease in the general price level of goods and services.

Hyperinflation

Hyperinflation is the rapid rise in prices of goods and services in an unpredictable manner. It's considered hyperinflation when prices sharply increase more than 50% a month. For consumers this means that a box of cookies could cost one amount in the morning and be higher in price by the afternoon.

Headline inflation

Headline inflation refers to total inflation and the general increase in the price of goods, inclusive of volatile figures that may be impacted due to economic conditions. Headline inflation is often closely related to cost-of-living shifts.

Background Information

The Importance of Price Stability

Price stability supports rising living standards, reducing uncertainty about the evolution of the general price level and, by extension, enhancing the transparency of the price mechanism. Moreover, price stability contributes to general welfare and certainly prevents the arbitrary distribution of wealth and income resulting, for example, from the erosion of the real value of nominal claims (savings in the form of bank deposits, government bonds, nominal wages) due to inflation. The large erosion of real wealth and income due to high inflation can be a source of social unrest and political instability. In short, by maintaining price stability, central banks help achieve broader economic goals and contribute to general political stability. Typically an average adult in the world today has an annual income of 16,700 euros (in purchasing power parity) and has a wealth of 72,900 euros. But, this is just a statistical average. The question is from which distribution it arises. The richest 10% of the world's population today receives 52% of the world's income, while the poorest 50% of the world's population receives only 8.5%. This means that a person in the richest 10% of the world's population earns an average of €87,200, while a person in the poorest 50% of the world's population has an average annual income of €2,800.

The Similarities and Differences between Inflation in the USA and the Eurozone

There are two more serious complications that make handling the inflationary explosion complex. The first issue is that inflation in the USA is mainly inflation of excess demand, that is, overheating of the economy, with unemployment at very low levels. In contrast, in the Eurozone, inflation is largely due to supply disruption, energy and food dependence on Russia and Ukraine and the consequent dramatic increase in energy costs (e.g. the price of natural gas + 400% from 2021) but also to the chronic structural weaknesses of the European economy. Treating the problem does not require exactly the same recipe in every country and therefore a different mix of economic policy and structural reforms is required, particularly in the Eurozone, where the course of energy, raw material and food costs will play a key role.

Factors Affecting Inflation

1. A serious issue is the large appreciation of the dollar, over 15%, against almost all currencies in recent months, which fuels inflationary pressures in the European economy, transfers the inflationary problem to developing countries, making domestic interest rate increases a one-way street, makes international borrowing prohibitively expensive, leads to capital outflows and inevitably increases the cost of servicing their foreign debt which is mainly in dollars. It is likely that several developing countries, including Turkey, will soon face serious financial difficulties. It is estimated that it will take at least two to three years before the contractionary monetary policy measures tame inflation in developed countries to acceptable levels e.g. of 2%-3% per year, provided that they are accompanied by a slowdown in raw material and energy costs, the implementation of fiscal stabilization measures and the avoidance of incorporating inflation into wage increases. It appears that the rate hike required will be greater than what the markets are predicting today, particularly in the US, where short-term rates will exceed, in my estimation, 5% to 5.5% and European rates 3% to 3.5% in the first half of 2023. Based on historical data, the containment of such a high rate of inflation cannot be significantly reduced without a severe economic slowdown (recession), which appears likely to occur in 2023. Already, international organizations estimate almost zero growth in the US and Europe and only a 2.7% growth rate for the world economy for 2023, with an increasing likelihood of it eventually being below 2%, while they peg the world population at close to 7% in 2023 and around 4.3% in 2024.
2. The second reason is the offsetting effect of large price increases in goods and services that are

consumed more by wealthier households. For example, high-income households in Germany spend a large share of their consumer spending on motor vehicles. Therefore, they were particularly exposed to the large price increase in this category. However, lower income households still remain vulnerable to high inflation resulting from the rise in basic goods. Such offsets simply mean that wealthy households are also hit by high inflation.

3. Another factor affecting inflation inequality in Europe is the effect of national policies. Since the end of 2021, EU governments have introduced various measures to protect citizens from rising inflation: energy tax rebate, horizontal price subsidies, energy cost relief for businesses. However, these measures do not necessarily follow the principles of equality. For this reason, governments must take into account not only the path of inflation, but also the different difficulties that households face in meeting their daily needs. The targeted support of vulnerable households is therefore deemed necessary and support measures in favor of low incomes have indeed been legislated in the EU.

Possible Actions Taken

Finally, if inflation does not subside in the long term, structural changes may also be needed. Since wages are traditionally more inflexible to price changes than other sources of income, revising indexation mechanisms in the minimum wage could help limit the loss of purchasing power of vulnerable households. The spike in inflation is due in part to the very large and sudden increase in demand seen when societies stopped implementing lockdowns. Suddenly, everyone started spending the way they did before the onset of COVID-19, which drove demand to the highest level since 1946.

Sub-topic 1: The developed countries' views and belief systems concerning inflation.

The inequalities observed at the global level mainly create social inequalities in a large part of the population and countries where inequalities are maintained and often reinforced. It is typical that the "middle" 40% of the world's population receives 39.5% of the world's income but owns only 22% of the world's wealth. Evidence shows that global inequalities remain today at the same level as they were at the height of Western imperialism at the beginning of the 20th century. And in fact the income received by the poorest 50% of the world's population is today proportionally about half of what it was in 1820 before the divergences between Western countries and their colonies intensified. Developed countries manipulate the inflationary phenomena at the expense of the poor, aiming for the wealth and control of their poorer citizens.

Sub-topic 2: The struggles that developing countries face on a daily occurrence due to the inflation rates.

Although the gap between the richest and poorest countries has narrowed slightly – the average income of the richest 10% of countries was 50 times that of the poorest 50% of countries, it is now 40 times, reflecting the faster growth of emerging economies, however, inequalities within countries intensified. This is also reflected in the fact that while in 1980 inequality between countries represented 57% of global inequality and the rest was inequality within countries, in 2020 inequality between countries represented 32% of total global income inequality and the rest was inequality within countries. The inability of governments in developing nations to improve economic inequalities is caused by increased prices of imported products such as food and energy. In some cases, the corrupt political nature of their governments (e.g. African regime) act detrimentally against their own citizens so that the people of these countries stay poor while their rulers get richer at their expense.

Sub-topic 3: The involvement and actions taken by worldwide organizations, concerning inflation rates on an international scale.

All the reports of international organizations show that inequality cannot be tackled simply by trusting the spontaneous dynamics of the economy. Even any improvement that appeared to have been made in curbing absolute poverty (in large part because a significant portion of China's population has been lifted out of poverty in recent decades) was compromised in the pandemic, when 100 million people were added to those experiencing extreme poverty. Against this, various proposals that have been made are of interest, regarding the resources that a progressive tax on the planet's multi-millionaires would mobilize and which could secure 1.6% of global incomes that could be invested in education, health and the ecological transition. As of August 2022, the harmonized index of consumer prices reached double-digit levels in the EU and exceeded 20% in the Baltic Member States. Economic analysis tends to focus on the impact of inflation on the overall economy, overlooking that the effects of price increases may not be the same across households. Inequalities in the Eurozone are particularly large for southern countries namely Belgium, Greece, Italy, Ireland, Latvia, Lithuania, the Netherlands and Spain from March 2021 to March 2022, low-income households face inflation between 2.6 % (in the case of Ireland) and 5.3% (in Italy), higher than high income households. The global economy experienced unique moments of uncertainty. The pandemic has led the global economy to a severe economic contraction and an unprecedented disruption of the domestic but especially the cross-border supply chain in the period 2019-2021. Governments, to deal with this unprecedented crisis, were forced to implement significant fiscal support measures that led to a significant increase in public debt in almost all countries of the world (e.g. US public debt as a percentage of GDP increased from close to 107% in 2016, 135% in 2020 and 120% today). Also, the level of fiscal support in Greece was particularly high, exceeding a total of 23 percentage points of GDP. Of 2019 (€ 44 billion). At the same time, in the same period, the monetary authorities of developed countries implemented unprecedented inflationary monetary relaxation measures, with zero or even negative interest rates and a significant increase in liquidity in the market, amounting to a total of over $30 trillion. Then came the Russian-Ukrainian conflict and turned everything upside down. The two countries are a key global source of energy, raw materials, metals and agricultural products. A price boom and market shortages were created because of the war and excess demand combined with the negative effects of climate change, a severe slowdown in the Chinese economy and disruption of the supply chain from China, mainly due to the measures against Covid-19. The burden of correcting inflation on the part of governments will necessarily fall on monetary policy, with measures to reduce liquidity in the market and a sharp rise in interest rates. The measures will lead to a slowdown in the economy, possibly to economic recession and rising unemployment, which will work beneficially to curb inflation, especially in countries where the main issue is excess demand. A key risk for the course and dynamics of inflation is also the degree to which current inflation will be incorporated into the formation of wages and labor contracts and whether or not this development will be accompanied by a possible rise in speculation and upward destabilization of inflation expectations. If the above happens, in part or in whole, tackling inflation will require, ceteris paribus, an even stronger contractionary monetary policy and for a longer period of time. But the current crisis has another important side effect. It sharply exacerbates social inequalities and significantly redistributes global wealth. Specifically, the countries that produce and export energy, raw materials and agricultural products are the big winners of the current situation, while the big losers are the countries that have a high degree of dependence for the above from abroad, primarily Europe. The depositors, with almost zero interest on their savings, are also the big losers and the winners are the banks and especially the over-leveraged.

Major Countries and Organizations Involved

United States of America

The U.S.' economy is one of the very few economies that could affect the world inflationary rate either positively or negatively. With that said, the U.S.A. is one of the most, if not the most, important country that's involved in the manipulation of inflation.

China

China has inundated the global economy with their products and can easily manipulate price indexes that's going to affect the global economy.

European Union

Being an economic powerhouse, containing multiple developed strong nations, the European Union plays a prominent role in dictating inflationary rates worldwide.

Timeline of Events

Date	Name	Description
1180 - 1350	First inflationary wave	This wave of inflation is characterized as "mild" (by modern standards), with price increases averaging only 0.5% per year
Last quarter of the 15th century – 16th century	Second inflationary wave	This wave began with small rates of price increase during the last quarter of the 15th century, when the population of Europe began to increase noticeably again. Once again, agricultural prices rose while real wages for workers fell.
Start of 18th century – End of 18th century	Third inflationary wave	This wave caused civil unrest, many revolutions, and major wars between states competing for colonial expansion and dominance. The original cause of this wave was population growth in Europe. Another reason was the budget deficits caused by the wars

First and Second World Wars	Hyperinflation	In this wave of inflation, the phenomenon of hyperinflation appeared, where the purchase value multiplied against the goods, with Germany feeling the brunt.
October, 24th, 1929	The Wall Street Crash of 29'	This wave of inflation created a worldwide depression lasting all the way up to the second World War.
October, 19th, 1973	Arab Oil Embargo	The Organization of the Petroleum Exporting Countries placed an Arab embargo on oil exports to Canada, the Netherlands, Japan, the United States of America, the United Kingdom, Rhodesia, Portugal, England, South America, etc. Oil prices then more than tripled from almost $3 at $11.5 a barrel. Exactly what is happening from 2021 with oil and natural gas.

Previous Attempts to solve the Issue

Efforts have been made to reduce the phenomenon of inflation in the past by putting forward some proposals such as taxing the richest countries and restraining the increase in the prices of basic goods and energy. Efforts should have political will and global acceptance. Given that the phenomenon of inflation concerns the demand for goods and the reduction of purchasing income of households. The richest 1% of the world's population managed to capture 38% of all the additional wealth accumulated since the mid-1990s, while the poorest 50% managed to capture just 2%. The wealth of the world's richest people grew from 6% to 9% every year since 1995, while the average increase in wealth was 3.2%. In fact, in 2020, the year of the pandemic, we also had the largest jump in the percentage that the many rich get from the world's wealth. According to the report's data, the share of household wealth held by the richest 0.01% of the world's population (that is, 520,000 adults in 2021) rose from 7% in 1995 to 11% in 2021. Then entry into this team was at 693,000 euros in purchasing power parity. Today it is at 16,666,000 million euros. Correspondingly, the percentage of global wealth owned by billionaires also increased and is now at 3.5% of global household wealth. The report also assesses the gender dimension of inequality. Women's participation in total labor income reached 30% in 1990 and is below 35% today. If we were in a world of true equality, their share should be 50%. This ultimately means little progress over the past 30 years.

Possible Solutions

Sub-topic 1:

Developed countries could create a global body where the formation of the prices of the basic goods that are traded on a global scale would put a bluff, and act as an observer to any action that would create a risk in this endeavor. Reducing the price of energy that is provided to the developing countries could result in less inflation and better quality of life. Furthermore, investing in small businesses, providing the developing countries’ citizens employment and a stable income.

Sub-topic 2:

Poorer countries will be able to create a working environment by including in their economy products that they can grow or fish and use for the same consumption but also export to increase their income. Also their governments could intervene in the international community asking for some mild measures and containment of inflation in these countries.

Sub-topic 3:

The U.N. could sign treaties, intervening in cases of exceeding a predetermined bluff and helping to reduce the rate of inflation by taking certain measures for analogous situations.

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