Q: What are the social costs of Inflation?

Ans: An economy which is experiencing inflation has to bear many costs and policymakers, economists and especially politicians are concerned to make arrangements and take steps to curb inflation because of public pressure.

There are different costs of inflation. They are:

Costs of Expected Inflation:

1. **Shoe-leather Cost**: One cost of expected high inflation is the distortion of the inflation tax on the amount of money people hold. A higher inflation rate leads to a higher nominal interest rate which, in turn, leads to lower real balances. If people are to hold lower money balances on average, they must make more frequent trips to the bank to withdraw money. The inconvenience of reducing money holding is called the shoe-leather cost of inflation.

2. **Menu Costs**: Inflation also arises because high inflation causes firms to bring changes in their prices printed in menu cards more often. This procedure is costly as it requires print and distribution of a new catalog. These costs arose due to high inflation are called menu costs, because the firms often revise the price list in their menu cards whenever the rate of inflation is high.
3. **Relative – price variability and misallocation of resources:** A third cost of inflation arises because firms facing menu costs change prices infrequently: thus, the higher the rate of inflation, the greater the variability in relative price. Since market economics rely on relative prices to allocate resources efficiently, inflation leads to microeconomic inefficiencies.
4. **Inconvenience:** Another cost of inflation is the inconvenience of living in a world where prices are changing and brings changes in the value of rupee. Money is used as a yardstick for measuring economic transactions and therefore, when an economy experiences inflation, that yardstick is changing in length.

Costs of Unexpected Inflation

Unexpected inflation has an effect that is more pernicious than any of the cost discussed under anticipated inflation. It arbitrarily redistributes income and wealth among individuals. We can see how this works by examining long- term loans. Loan agreements specify a nominal interest rate, which is based on the expected rate of inflation.

Unanticipated inflation also hurts individuals on pension. Workers and firms often agree on a fixed nominal pension when the workers retire. Since pension is deferred earnings, the workers are essentially providing the firm a loan. Like any creditor, the worker is hurt when inflation is higher than anticipated. Like any debtor, the firm is hurt when inflation is lower than anticipated.

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