4 Money and Prices

A very important property of any economy over time is the degree to which it has experienced inflation or deflation of prices, including money wages. Any monetary unit like the dollar is subject to fluctuations in its general purchasing power because of changes in money prices. We try to measure these fluctuations by constructing a price level index or a price deflator (or inflator), of which there are many varieties. There is some dispute among economists that has never quite been resolved as to what the ideal price index should be. One index is calculated by estimating how much money it would take to buy a ‘market basket’ of relevant commodities, corresponding more or less to the relative quantities that are produced or consumed. Other measures have been proposed, but this seems to be the simplest and perhaps the most meaningful. A difficulty arises, however, when deciding which market basket is significant when the relative quantities of commodities actually purchased change over time. The price level index will be different if we take the market basket at the beginning or at the end of the period. When there is a change in the quality of commodities, and when new commodities appear, the task of defining a price level in an exact form becomes virtually impossible and we have to be content with rough measures (Chapter 1). These indexes however are better than nothing. Different sectors of the economy may require different measures of price levels as they constitute significantly different market baskets. The sixty-year history of some of these measures is shown in Figure 4.1 (for GNP), Figure 4.2 (for personal consumption expenditure and gross private domestic investment) and Figure 4.3 (for exports, imports and government purchases of goods and services). In all of these there was sharp deflation during the Great Depression: about 25 per cent for GNP, personal consumption and gross private domestic investment; nearly 50 per cent for exports and imports; and only 12 per cent for government purchases (summarised in Table 4.1).

Since then there has been almost continuous inflation, which from 1929 to the present has served to increase the price level of GNP by 7.8 times, that of personal consumption expenditure 6.7 times, gross private domestic investment 9.9 times, government expenditure 12.8 times, exports 5.8 times and imports 7.2 times. These differences

K. E. Boulding, *The Structure of a Modern Economy* © the estate of the late Kenneth E. Boulding 1993
Money and Prices

Figure 4.1 Implicit price deflator (1), US 1929–89


Figure 4.2 Implicit price deflators (2), US 1929–89