Inflation is a sustained increase in the price level. The increase is continuous and reflects increases in the average of general prices. The issue of inflation is universal and commonly discussed and assessed by economists. Through extensive research and analysis, many efforts have been made to fully understand the costs to and effects on the economy. Whilst there is a general consensus among economists that inflation is a negative force in the economy, much conjecture has arisen questioning the extent and significance of inflationary impacts on the economy and policies that can control it. There are several costs to the economy that are a direct result from periods of inflation. These include resource misallocation, capital misallocation, transaction cost such as shoeleather costs and menu costs, arbitrary redistribution of wealth and income, tax liabilities, increased uncertainty, confusion and inconvenience. Each of these will be elaborated on throughout the paper. These costs not only have unfavorable impacts on business's and individuals but also adversely effect the economy as a whole. Many of the costs identified however, cannot be quantified or measured with and certainty. This factor has and will continue to understate the validity of results generated through the research and efforts of economists in their quest to find the "true" costs of inflation to the economy. There is evidence that does detail the adverse impacts of inflation to the economy, namely in the areas of economic growth, resource efficiency, productivity, investment and employment. It s simply a case where the exact costs are unknown.

A price level characterized by in stability can lead to great uncertainty in the economy. If the inflation level of a country is volatile and varying on a continuous basis then the level of investment, consumption and economic growth are likely to be impeded. The rationale

for this, supported through historical reference, is that in such a case, firms become increasingly reluctant to invest in new plant and equipment. This reluctance is derived from uncertainty about the direction of the economy and the possible actions of the Government in future periods. Consumers may also become hesitant or less inclined to spend as a result of the uncertainty. Each of these outcomes is capable of reducing the level of economic growth. The magnitude of this possible reduction is not only dependent on the rate of inflation but also factors other related economic indicators.

Through historical reference and other research forms, evidence of a misallocation of resources resulting from inflation and inflation uncertainty has arisen. One such example of resources being misallocated can be attributed to the distorting effects that inflation can have on the price system. The decision making process of business's is one based and evaluated against the backdrop of the firm's money flows. Indicators such as revenue, costs of inputs, profit levels etc. are assessed before decisions of any significance can be made. These decisions are therefore a function of information. The more accurate the information available to the business, the better educated they are to make the right decision so as to achieve the most efficient outcome or desired result. Inflation causes prices to change more frequently and in occurs in ways that distort the market's network of information. The market's information system can best be characterized as a system of relative prices. If the individuals that bare the responsibility of making decisions misinterpret prices then they are in a position capable of misallocating resources and capital from there most efficient use. In this case resource misallocation could either involve producing too much or too little of the good subsequent to the misreading of the true relative price of the good in question. The m0isallocation of resources can also be

represented through the potential outcome of buying too much of one input or too little of another based on the reasoning or perception that one appears to be ‘cheaper’than the other. These types of outcomes are a common occurrence in the economy and reflect one of the more significant costs of inflation. The cost itself impacts on the firm’s productive efficiency and the potential profits to be earned.

Inflation, through its effect on the price level also creates a cost to the economy through increases in transaction costs. Within the context of inflationary impacts there are two types of transaction costs. These being shoeleather costs and menu costs.
Shoeleather costs refer to the costs that arise from engaging in a greater level of financial transactions as the cost of holding lesser amounts of money. These costs can be attributed to the decline in the real value of money during periods of inflation. As the value of money declines, individuals become more inclined to economise on their personal holdings of money. The desire to hold cash on hand becomes less attractive and alternative arrangements are sought. These include equities, mutual fund shares, bonds that offer a higher rate of return than money etc. the problems these individuals face or the costs they endure stem from the fact that in order to carry out transactions they will require money. The resulting outcome from this is that individuals expend greater time and money through their involvement in a series of financial transactions. This process involves transferring funds from illiquid accounts into liquid accounts so as to enable them to make payment. This process consumes both time and effort and in some cases will also involve some monetary cost.

Menu costs are more of a direct cost to businesses and refer to the costs associated with changing the prices of that particular business's goods. Businesses are conscious of changing their price as it can be a costly procedure and as a result try to make changes as infrequently as possible. The procedure can often involve either entering new prices into the computer system, attaching new price stickers, printing new product catalogues or in the case of restaurants /cafés', changing the menu. Each of these involves some cost to the business. Periods of inflation lead to greater price volatility and price changes which subsequently lead to business's changing their prices more frequently and thus at a greater cost to them.

Periods of inflation will have an effect on the distribution of income and wealth in the economy with a costs represented through the nature of the distribution process, with inflation present characterized by arbitrary distribution. The reasons why and the process at which this occurs is the result of many people having an income structure on fixed terms. The relationship between income and inflation is that in times of high inflation the less the worth of these fixed incomes. This effect can also work with relation to the income itself changing relative to the amount in which the inflation rate changes. It is these effects that arbitrarily redistribute wealth and income to the economy. Whilst there will be people that do gain from this process, again o function of the movements in the inflation rate, it is those individuals that lose out that bare the costs of inflation through no fault of there own. There is a cost that can result out of the general economic unhappiness that this creates in the area of greater Government involvement or at least requests for this. It is the people that have been treated unfairly that push for new

legislation that will ease their pain through an endeavor to create greater equality in the outcomes. In this way, inflation can grind down the rule of law that is an integral and very important aspect of a productive, growing economy. Private contracts, which through the forces of inflation, are subject to arbitrary losses (or gains) will give way to the actions of Governments and their agenda's aimed at producing particular results. It is not uncommon for countries to emerge from inflationary periods with a more regulated and less efficient economy than before.

Tax liabilities are another cost to the economy that results from inflation. The extent of cost is dependent upon tax system in question. A tax system that is fully indexed will not incur the costs of inflation. It is a tax system that is non-indexed that creates costs for the economy. In this case the cost of inflation can be represented by the costs involved in amending the system to one of a fully indexed nature.

The inverse relationship that exists between inflation and unemployment also requires some recognition when assessing the costs of inflation and the adverse impacts it has on the economy. With particular reference paid to trends and outcomes over time, an inverse relationship is evident between the level of unemployment and the rate of inflation. With an overall perspective in mind, whilst the costs of inflation are evident and at times significant enough to adversely impact on economic growth, production, investment and employment, there is little doubt in the minds of policy makers and economists alike that these costs are greatly exceeded by the costs to the economy of unemployment. As a result of this perception, policy's aimed at controlling or influencing the inflation rate are

not treated as great a priority as policy's aimed at reducing the amount of people unemployed.

Inflation can also adversely impact on the balance of payments. If the prices in this country increase at a faster rate than those in other countries, then the goods of this country will be less competitive and less in demand. This will have a negative effect on the balance of payments.

Periods of inflation can potentially trigger a series of price adjustments that over time get out of control. The rationale behind this is that as prices increase so to does the demand for higher wages by workers as they try to maintain their living standards. Businesses will naturally respond to this with an increase in prices so as to maintain profits. This cycle can continue until the inflation rate is out of control of the authorities.

Inflation can also create costs for the individuals in the money market with favorable outcomes for borrowers at the expense of savers. The reason for this is that inflation erodes the real value of the existing debts. Related to this, the rate of return on loans may not cover the rate of inflation.

The various costs illustrated throughout the paper given an indication of the many costs associated with inflation and the adverse impacts that inflation has on the economy. The rate of growth in the economy is affected through a variety of channels pursuant to the subsequent impacts of inflation. Inflation has several direct negative effects on the

allocation of resources and the efficient use of these resources is can be significantly compromised. The productive efficiency of firms is reduced through the forces of inflation on the price system. Investment is also affected through the uncertainty and confusion that inflation imposes on the economy. The level of employment is as noted related to the inflation rate. Policy's aimed at reducing the inflation rate may achieve their desired outcomes in the context of inflation but not without significant harm to the level of unemployment. The tradeoff that exists is a large aspect of inflation analysis and the costs associated though general public perception favors the level of unemployment as a more significant cost indicator to the economy. For this reason, whilst the costs of inflation are evident they are accepted as a less costly outcome than the alternative cost to society of unemployment. The fact that inflation analysis until now has failed in many areas to produce quantitative results that reflect the exact magnitude of the costs to the economy in the areas mentioned, has played a part in the current perception of this tradeoff. In many cases however, given the variables in question and the state or dynamic nature of the economy, it appears an impossible task to establish with any certainty or evidence the 'true' costs associated with inflation.