

The Costs of Inflation

Unanticipated inflation helps some people and hurts others. For example, borrowers are helped by unanticipated inflation while lenders are hurt. However, even anticipated inflation results in costs for the economy. There are three types of costs that result from inflation: shoe leather costs, menu costs, and unit of account costs.

Shoe leather costs: increased transaction costs caused by inflation.

The term *shoe leather costs* comes from the idea that inflation results in the need for more trips to the bank and store, wearing out peoples' shoe leather. While technological advances have decreased the amount of walking required to conduct transactions, shoe leather costs still exist in the form of actions that people must take as a result of inflation. Shoe leather costs can be quite substantial in an economy with *hyperinflation* (very high inflation rates).

Menu costs: the cost of changing a listed price.

Inflation requires firms to incur a cost to change their prices. As a result of inflation, firms must change the tag on the product or shelf, the information attached to a UPC code in a computer, the sticker price on a car, or reprint a restaurant menu (the origin of the term). With hyperinflation, menu costs can cause consumers and merchants to abandon prices listed in their local currency. Menu costs can be substantial in times of high inflation.

Unit of account costs: the cost of having a less reliable unit of measurement.

One of the uses of money is as a unit of account. Prices are used to compare the value of goods and services. Inflation can decrease the usefulness of prices for comparisons because it changes the purchasing power of a currency over time.

1. For each situation, place an X in the box representing the cost of inflation that is best represented.

Situation	Shoe leather costs	Menu costs	Unit of account costs
(A) Your favorite local restaurant raises its prices and has to print new advertisements.			
(B) Workers in Germany in 1922 are paid and shop three times a day due to hyperinflation.			
(C) You have to change your automatic bill payment in your online banking account because the rent for your apartment went up.			
(D) You remember when the price of gasoline was \$1.25 per gallon.			
(E) You work at your local grocery store and place new higher price stickers on the store's shelves.			
(F) Your weekly grocery bill increases, but the amount of groceries you purchase does not.			