Prices are Going Up - The Inflation Tax and How it Works

June 28, 2021 - If you think prices are going up on just about everything, that isn't your imagination. Fuel costs alone have risen around 30% since January. The prices of food, clothing, lumber and just about everything else seem to be going through the roof. Overall, 2021 could wind up with an inflation rate of 5% or more. That's a huge increase when compared with the past few years and is nearing a 30 year high. But that may be the government's plan, because inflation driven by huge government spending is nothing more than a tax.

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If you've never heard someone say that inflation is a tax, then think of it this way. In order for the government to issue new money, it sells bonds. And if you purchase $100 in bonds that pay 2% interest, at the end of 12 months you will have $102. As long as inflation stays at 0%, that $2 is a profit. But let's say that inflation jumps to 5% just after you buy your bonds. At the end of 12 months, you would actually be losing money. That's because while the government is paying you 2%, the value of each dollar is dropping by 5%. In essence, you just paid the government the difference or 3% and gave the government a loan in the process.

That's a simplified scenario but you get the idea. Inflation can be a real friend to politicians who want to spend but who don't really want to take a public vote to raise your taxes. It is also far from the only tax scenario that comes into play. Here are a couple of more.

You work for a company that gives you an annual cost of living increase in your wages. But the latest increase places you into a new tax bracket. Under that circumstance, you could actually wind up taking less money home than you did prior to the time you got your raise. That's a scenario that is fairly common.

Another is that you purchase an investment such as gold. For the record, gold is an anti-inflationary investment. In terms of real spending power, one ounce of gold today will purchase about the same thing that it would have 100 years ago. But that isn't how the government sees it. In 1920, one ounce of gold was worth $20. Today it is worth $1,800 an ounce. But if you had purchased gold in 1920 and sold it today, the government would tax you as if you actually made $1,780 at the time of sale, even though you really have the same buying power today that you would have in 1920.

Unfortunately, inflation also tends to hit the people who can least afford it the hardest. Those making minimum wage or on fixed incomes are the most affected. But that doesn't seem to be bothering congress or the White House too much these days. They continue to propose huge spending bills that will only make inflation increase faster.

So the next time someone is talking to you about some great government plan for infrastructure, or solar power, or anything else for that matter, think about it first. If they tell you that they are not increasing taxes to pay for that great plan, that really isn't true. In the end, there are no free lunches. We will all wind up paying for these programs, one way or another.
by Jim Malmberg
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