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Inflation, High Inflation Hyperinflation

The importance of drawing a distinction

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When reflecting on the complex inflationary situation in today's world, I wonder why it is important to distinguish "inflation", "high inflation" and "hyperinflation" in a country's economy and why this distinction should not be trivialized.

A few years ago, when reading the macroeconomist Robert Barro, I learned that the main purpose of a central bank, the purpose for which it must exist and its almost obsessive purpose, should be to "control inflation". After living for years in a permanently inflationary economy, I could not agree with him more and I emphasize the importance of his thought.

It doesn't seem to be big news when annual inflation is 2% or 4%, in fact, **many, if not all, countries have some level of inflation**; but only when that inflation begins to grow steadily, the alarms go off and the information about its impact, how to act and face the distortion show up on radar. Countries can show levels of inflation that could be designated “common inflation”, and yet their people have a purchasing power that allows them to plan how to spend their revenues, how much to save, and to maintain a predictable standard of living.

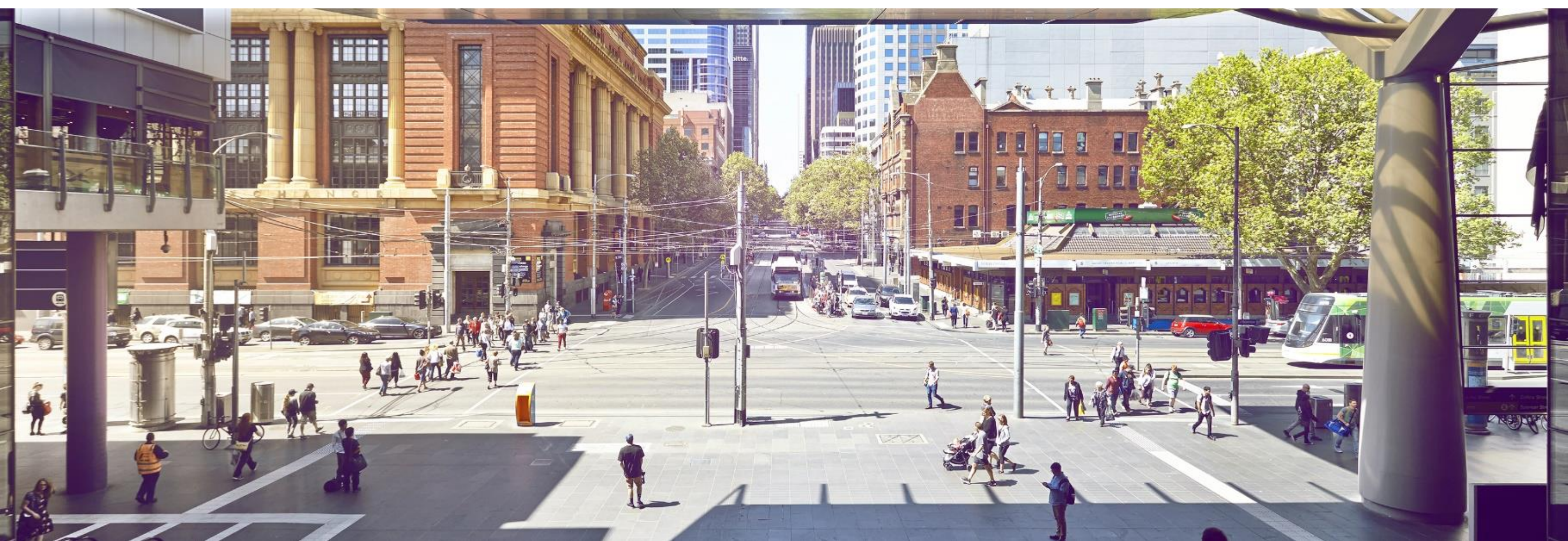
The first fear arises when inflation advances at an increasing rate towards exceeding double digits per year and from then on the monthly publication of the indicator remains on the permanent news radar and becomes a matter of national interest for analysis. Why? From the economic and social point of view, we can see how harmful a **highly inflationary** economy is for a society. Individuals begin to lose purchasing power because their revenues do not rise in proportion to their expenses and accordingly, the capacity to meet their basic needs decreases, thus generating, if it is not controlled in time, the overall impoverishment of the population with the troubles that all this entails malnutrition, violence, deprivation, crime, among others. Therefore, as soon as the first signs of an inflationary trend emerge, the professional and media sectors begin to warn about its dangers and a good central bank and the government itself should focus on controlling it in the early stages.

The inflation definition is widely known. In plain terms, **inflation** is the widespread and sustained increase in prices of goods and services, which has the effect of losing the purchasing power of the currency. Note that these are not individualized increases and/ or at a given time, but generalized and sustained increases over time; hence its detrimental effect because it is a race in which the individual always goes behind. Now, regarding the distinction between "inflation", "high inflation" and "hyperinflation" we cannot find an absolute concept, but we will refer to the different perceptions of economists and accountants and their related grounds.

It is accepted by convention **between economists and media professionals that hyperinflation exists when the inflation rate exceeds 50% per month**. This connotation comes from an article published by Phillip Cagan in 1956[1], through which he analyzes the relationship between changes in the quantity of money and the price level during hyperinflations and states that the definition is purely arbitrary, but it serves the purpose of his analysis. This definition has not been formally updated by economic science in the context of new times and new global inflationary trends and their effects on societies.

On the contrary, accounting science has been concerned with clearly defining **Hyperinflation** within its rules and principles and establishing how to measure its effects and acknowledges that, when this is achieved,

[1] *The Monetary Dynamics of Hyperinflation*, an article included in *Studies in the Quantity of Money*, published by Milton Friedman, University of Chicago Press, pages 25-117



the financial statements must reflect these effects through the application of accounting techniques.

This has its *raison d'être*.

The accounting technique analyzes various levels of inflation that the economy of a country may present. And, as it is commonly known worldwide, accounting science allows itself to ignore inflation, whether low or high, because it does not generate comparative distortions, but it does require recognizing it in the financial statements when **Hyperinflation** is reached. This requirement has historically been recognized in Venezuela through technical pronouncements[2].

When is that limit reached??

International accounting standards recognize that defining the hyperinflation status is not an absolute rate but the analysis of the conditions of the country's environment, but they clearly define **hyperinflation condition when the accumulated inflation is greater than 100% over a period of three years, among other qualitative aspects**; however, the accounting profession in many countries has determined that the effects of inflation on financial statements should be recognized when it reaches 10% per year, Venezuela and Mexico are examples of this.

That is, accounting requires acknowledging high inflation in the financial statements from that moment on which any comparison between the amounts occurred at different points in time is considered unclear, then it is scaled up to **Hyperinflation**.

Ignoring the effects of an economic event of such significance on any company's management, such as high inflation, implies risking its sustainability over time. Accounting science is beautiful and is designed for financial reporting to give us useful information to make decisions.

It is not the same to manage in a stable economy than in a hyperinflationary one and the ability to manage in an environment with these challenges is reflected in the management results, which are used for analysis, taking actions and even redirecting decisions, if necessary, to ensure the sustainability of the company under its particular environment.

Ignoring inflation means to start from financial information that can be misleading because it does not provide enough data to understand the context and look for appropriate alternatives. This would lead to ignoring the effects of inflation on managerial decisions.

Under current global trends, accounting associations in countries will need to define whether to adhere to the international benchmark or establish a more conservative high inflation benchmark (e.g., 10% per year) to recognize the effects of inflation on financial reporting.

Recognizing inflation implies an accounting methodology that is not known worldwide because not all countries have gone through it.

In Venezuela we have great technical and management experience that we can contribute to the world to save efforts and the cost of natural first-time mistakes we have already learned from practice and masterfully manage.

[2] Since the outdated Statement of Accounting Principles N° 10 (DPC-10) and, currently, the BA VEN-NIF 2, it has been required to recognize the effects of inflation on the financial statements when it exceeds 10% per year.