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Many Consumer Prices Are Higher: Time to Eliminate Government-Imposed Economic Roadblocks

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KEY TAKEAWAYS

Recent increases in the Consumer Price Index (CPI) have many Americans worried that the U.S. could be returning to an era of high inflation.

The CPI increases are mainly due to pandemic-related supply disturbances, so enacting polices that create more upward price pressures would worsen the outlook.

Congress must eliminate government-imposed economic roadblocks that create upward price pressures and address pandemic-related disruptions driving price increases.

Recent increases in the Consumer Price Index (CPI) have many Americans worried that the U.S. could be returning to an era of high inflation. Given that higher food and gasoline prices—items that are always in high demand—have been two of the main drivers of the recent CPI surge, these fears are perfectly understandable. While it would be a mistake to dismiss consumers' inflation fears, especially given the role that expectations can play in future price levels, it would also be a mistake for Congress or the Federal Reserve to enact new policies that would worsen the current economic outlook.

It would be a blunder, for instance, if the Federal Reserve immediately decreased the amount of money in the economy (tightened its policy stance) for the sake of hitting an inflation target. The economy has been hit with a massive supply shock, which led to shortages of all kinds of goods and even workers. Shrinking the money supply in these circumstances would starve the economy *even further*. In other words, it would leave people with even less money to purchase even scarcer items, making it more difficult than it already is to buy goods and services.

Similarly, it would be a mistake for Congress to enact new deficit-financed spending proposals, even under the guise of infrastructure. Previous stimulus bills have left many households with unusually high disposable incomes, and employers are having a difficult time hiring and re-hiring the workers that they need. There is no lack of consumer demand or job opportunities, so additional deficit spending will do little more than lead to upward pressure on prices. These new proposals will not alleviate shortages by creating more livestock and gasoline, or by increasing the number of workers in the economy. They will create inflation because they will provide people with more funds to pay the same suppliers who still face the difficulties that caused the shortages in the first place.

If policymakers respond inappropriately to the recent price increases, they will likely worsen the economic problems that Americans are now facing and prolong the economic recovery. Pandemic-related disruptions have been driving price increases in specific market segments, and policies that fail to mitigate those specific disruptions run the risk of making it even more difficult for people to get the goods and services that they need. This *Backgrounder* provides a list of policies that federal officials should avoid, as well as some that they should enact, to speed up the economic recovery. If Congress is truly concerned with high consumer prices, now is the perfect time to start eliminating the countless government-imposed economic roadblocks that put upward pressure on prices.

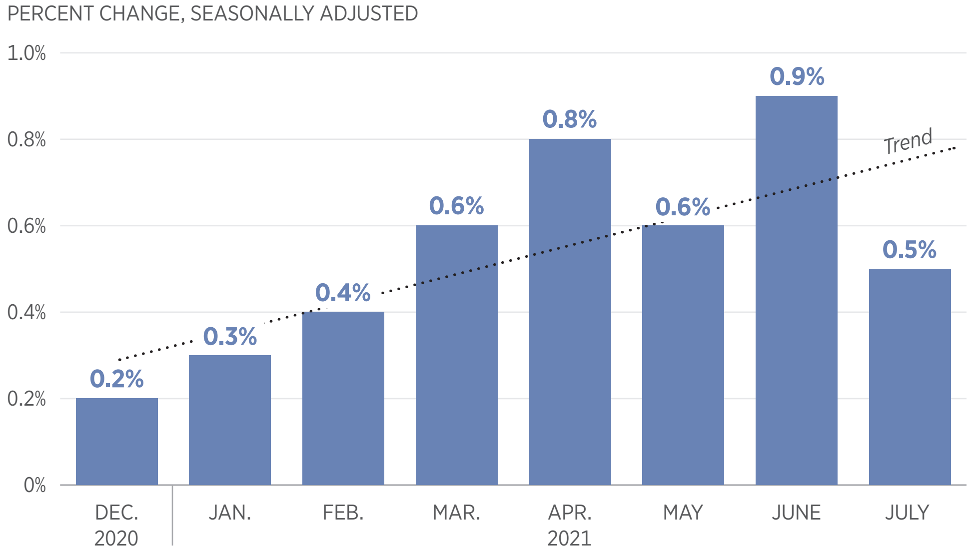
Headlines Show Rising CPI

On a month-to-month basis, the CPI rose 0.5 percent in July, after an increase of 0.9 percent in June.[1] Although the July CPI increase is smaller than it was in June, the index remains on an upward trend since December 2020. (See Chart 1.) The June increase was the largest *monthly* change since June 2008, and the two most recent *annual* increases, both 5.4 percent (between June 2020 and June 2021, and July 2020 and July 2021, respectively), were the largest yearly increases since August 2008.[2]

The year for these previous record changes—2008, during a global financial crisis—provides a critical clue for developing the correct policy response to the recent CPI surge. That is, a major economic shock occurred in both

CHART 1

Monthly Consumer Price Index Changes



NOTE: Figures represent month-to-month changes in the Consumer Price Index for All Urban Consumers (CPI-U).
SOURCE: Bureau of Labor Statistics, "Consumer Price Index Summary," August 11, 2021, https://www.bls.gov/news.release/cpi.nr0.htm (accessed August 11, 2021).

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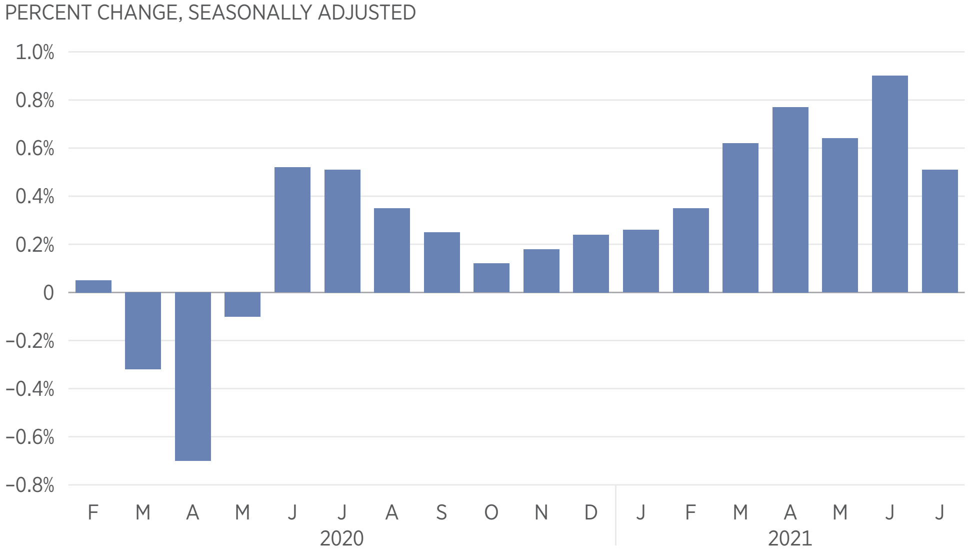
2008 and 2020, so policymakers must examine precisely what is driving the recent CPI changes before they can respond properly.

The 2020 shock has a clear cause: the global COVID-19 pandemic and the corresponding government responses. Protective measures (such as quarantines) and shutdown orders resulted in major disruptions, including the ability of people to work and, especially in the hospitality and travel industries, the loss of customers. In economic terms, some of these disruptions appeared as a massive decrease in consumer demand—people were buying fewer goods and services relative to what they had purchased prior to the pandemic. Between the fourth quarter of 2019 and the second quarter of 2020, total (nominal) gross domestic product (GDP) fell from $21.7 trillion to $19.5 trillion, a rapid decline of economic activity that surpasses anything in the historical record.[3]

The CPI figures in 2020 reflect this decreased consumer demand. For instance, in April, May, and June 2020, the *annual* changes in the CPI were just 0.2 percent, 0.3 percent, and 0.7 percent, respectively.[4] Each of these increases were abnormally low—the average change between April of a given

CHART 2

Recent CPI Surge Follows Early Pandemic Decreases



NOTE: Figures represent month-to-month changes in the Consumer Price Index for All Urban Consumers (CPI-U).
SOURCE: Bureau of Labor Statistics, "Consumer Price Index Summary," August 11, 2021, https://www.bls.gov/news.release/cpi.nr0.htm (accessed August 11, 2021).

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year and the preceding year, for the period 2000 to 2019, was 2.1 percent, as it was for annual changes in both May and June.[5] Similarly, the recent surge in *monthly* CPI figures follow several consecutive *decreases* in the CPI near the beginning of 2020 (March, April, and May), as well as a declining trend that lasted through October 2020. (See Chart 2.)

As governments began lifting pandemic-related restrictions, and a larger portion of the population received COVID-19 vaccines, businesses began reopening and consumer demand rapidly increased.[6] Yet, due largely to disruptions linked to the pandemic, many businesses were unable to supply the consumer goods necessary to meet that demand. Given the nature of the economic shock from the pandemic and the government shutdowns, there is no reason to expect a one-for-one return of the CPI to its previous path. Put differently, there is no reason for the CPI to increase 2 percent in 2021 simply because the CPI was 2 percent lower in 2020—no federal agency (or Congress) has such control over the price level or the aggregate economy. It is, therefore, critical for policymakers to examine exactly what is driving these abnormally large swings in the CPI.

Few Components Driving CPI Higher

Even though the recent CPI increases are partly due to pandemic-related policies, it is perfectly understandable that many Americans are now worried about higher inflation.[7] This nervousness is even more understandable given that consumers are experiencing higher prices that directly affect their household budgets. Close inspection of the various CPI spending categories, for instance, show that price increases in food and gasoline are among the primary drivers of the recent CPI surge. Several travel-related expenditures, as well as used car and truck prices, are also among the main factors. Though the exact contributions have varied for each category, prices for these items have been the main causes of the past several months of CPI increases.[8]

For example, as with June, almost 25 percent of the July CPI increase was driven by gasoline prices. The increase in gas prices (from July 2020 to July 2021) explains 22 percent of the increase in the overall annual CPI change.[9] A surge in used-car and used-truck prices account for another 20 percent of the increase in July, while transportation services (including a 73.5 percent increase in car-rental rates) explain an additional 6 percent.[10] These figures demonstrate that prices in just three categories explain almost half of the CPI increase.[11] Lodging and airfare account for an additional 4 percent and 2 percent of the annual increase, respectively.

While food prices account for another 9 percent of the annual increase in July, 5 percent of the increase shows up in spending on *food away from home*, such as meals at restaurants, while 4 percent is explained by rising prices in grocery stores (*food at home*). In June, however, food prices accounted for 6 percent of the annual CPI increase, but most of that increase was in spending on *food away from home*.[12] (Incidentally, the opposite pattern occurred from 2019 to 2020, when *food at home* prices increased more than prices for *food away from home*). While prices for *food at home* are responsible for only 1 percent of the annual CPI increase in June 2021, that figure does mask a great deal of volatility within the *food at home* category.

For instance, between June 2020 and 2021, breakfast cereal prices fell 0.3 percent, and rice, pasta, and cornmeal prices fell 1.5 percent. Yet, the price of bread increased 1.5 percent, and the price of milk rose 5.6 percent. Although the price of raw ground beef declined 8.4 percent, the price of bacon and related products rose 8.4 percent. Similarly, even though the price of poultry rose 1.2 percent, the price of fresh whole chickens decreased 0.8 percent, and the price of other uncooked poultry including turkey increased 5.6 percent.[13] Thus, consumers have been seeing all kinds of price increases in food.

While higher prices in certain food categories have surely contributed to consumers' inflation fears, food prices are historically volatile and not always indicative of overall inflation. For example, the Bureau of Labor Statistics (BLS) reports that "prices for food at home increased 4.8 percent for the year ended May 2020, with prices for all six major grocery store food groups rising over that period," even though the overall CPI increased just 0.1 percent over the same period.[14] Thus, it would be a mistake for policymakers to treat these higher food prices as if they, alone, represent higher inflation (a persistent increase in the overall CPI).[15]

Regardless of the normal volatility in food prices, price spikes in a limited number of consumer goods categories are clearly driving the recent surge in the CPI. Moreover, most of these individual price changes are undoubtedly related to economic difficulties associated with the pandemic. Policymakers cannot possibly craft appropriate policy responses without paying close attention to the reasons causing these individual price increases.

Turmoil in Specific Market Segments Driving Prices Higher

Prices for gasoline, used cars and trucks, certain transportation services, and various types of food are responsible for most of the recent surge in the overall CPI. Each of these markets has unique factors that help to explain its specific price changes, but many of these factors are related to COVID-19 and the policies that governments enacted to deal with the pandemic. Higher prices in some of these categories have been worsened because several government programs have made it more difficult (and costly) to hire workers. In some cases, additional policies—such as those that make it more costly to refine gasoline—exacerbate the pandemic-related disruptions that put upward pressure on prices. A brief description of these market disturbances follows.

Gasoline. Separate from any pandemic-related problems, gasoline prices are notoriously volatile. For instance, gas prices fell 39 percent from April 2008 to April 2009 and rose 38 percent from April 2009 to April 2010. From 2000 to 2021, the typical variation in the April-to-April rate of change for gasoline prices is 23 percent.[16] In the past two years, consumers have experienced even more volatility. Gas prices *fell* 32 percent from April 2019 to April 2020, 34 percent from May 2019 to May 2020, and 23 percent from June 2019 to June 2020. As demand recovered, gas prices rebounded, rising 50 percent from April 2020 to April 2021, 56 percent from May 2020 to May 2021, 45 percent from June 2020 to June 2021, and 41.8 percent from July 2020 to July 2021.[17]

In addition to resurgent consumer demand, another factor causing higher gas prices in 2021 is the constrained supply (and higher prices) in crude oil, the main raw ingredient needed to manufacture gasoline.[18] Multiple reports indicate that disruptions in crude oil production—for various pandemic-related reasons, including the inability to accurately forecast the reopening of the world's economies—contributed to a crude oil shortage. That is, relative to the amount needed to satisfy the unexpectedly high demand during recent months, producers (in multiple countries) were unable to produce enough crude oil.[19] This relative scarcity in crude oil magnifies the upward price pressure from the resurgent demand.

Just prior to Memorial Day, U.S. gasoline markets encountered several other disturbances. For instance, a cyberattack suffered by Colonial Pipeline temporarily shut down the "main pipeline carrying gasoline and diesel fuel to the U.S. East Coast."[20] Other supply disruptions were due to seasonal regulatory requirements, rules that further amplified upward price pressures. The U.S. Energy Information Administration (EIA) reported:

> Rising vaccinations and the gradual recovery in overall U.S. economic activity since the beginning of 2021 has contributed to increases in U.S. gasoline demand. However, refinery production of gasoline has not kept up with increasing U.S. gasoline demand because of unplanned refinery and pipeline disruptions in recent months, which have contributed to rising retail gasoline prices.
>
> West Coast states tend to have higher gasoline prices because of the region's limited connection with other major refining centers, tight local supply and demand conditions, and more environmentally stringent gasoline specifications. Texas continues to have the lowest gasoline price among the states included in our survey. Texas produces a relatively high amount of gasoline because it has more crude oil production and operating petroleum refining capacity than any other state, as well as relatively low state gasoline taxes.[21]

The "environmentally stringent gasoline specifications" in this passage refer, partly, to seasonal constraints on refining due to government-mandated special gasoline blends. Specifically, refineries retool their operations during the spring to switch from winter gasoline blends to summer blends, and these special formulations typically add between 5 cents and 15 cents to the per-gallon price of gas depending on the region (various states have different standards).[22]

Separately, several U.S. refineries permanently closed their doors during the pandemic, further straining the industry's already tight refining capacity. By December 2020, petroleum refining capacity in the U.S. had fallen to its lowest level since May 2016.[23] In July 2021, the EIA announced that "the beginning of 2021 marks the lowest annual capacity figure to start the year since 2015."[24] It appears that at least some of the recent refinery closures are due to companies' desire to produce less gasoline and more renewable diesel fuels, a shift that worsens the relative scarcity of gasoline and, therefore, puts more upward pressure on gas prices.[25]

Likewise, California Governor Gavin Newsome's (D) recent announcement that the state will mandate "sales of all new passenger vehicles to be zero-emission by 2035" is likely to add to the relative scarcity of gasoline (at least regionally) and put additional upward pressure on prices.[26] At the federal level, the Biden Administration has implemented, or is in the process of developing, policies and regulations to restrict the supply of oil. Among these, the Administration is maintaining a moratorium on leasing and permitting for new oil production on federal lands and the outer continental shelf, has revoked the Presidential Permit to construct the Keystone XL pipeline to bring Canadian oil to Gulf Coast refineries, and has initiated stringent climate regulations on oil production and processing facilities as well as on products that use oil (including cars and trucks).[27]

Additionally, considerable political risk has likely limited private-sector investment in refining and oil production as the Biden Administration and some in Congress consider sweeping economic policies in service to the Paris Agreement. Strangely, even though the Administration is acting to restrict U.S. production, it has also called on members of the Organization of the Petroleum Exporting Countries (OPEC) to *boost* oil production, a seeming admission that more production is necessary to meet higher demand.[28] Nonetheless, even prior to this plea, it appears that both OPEC and U.S. production of crude oil, as well as U.S. refinery production, have started to pick up.[29] Still, given that U.S. consumption of petroleum products hit a 25-year low in 2020, with decreases in *every* energy-consuming sector, it is likely that complete recovery will take some time.[30]

Used Vehicles and Transportation Services. The market for car rentals, used cars, and even new cars suffered major disruptions during 2020 and 2021. The car-rental market, especially, still faces a severe shortage. To survive the large drop in demand during the pandemic, the major car-rental companies employed a fleet-shrinking strategy, whereby they sold off nearly 800,000 vehicles—a decision that removed more than one-third of all available rental cars from the market.[31] Additionally, Hertz, one of the largest car-rental companies in the world, filed Chapter 11 bankruptcy for its U.S. operations in May 2020. The company has now emerged from bankruptcy after a "successful restructuring process," but it has not fully rebuilt its fleet.[32]

As with the fuel industry, because the economy started recovering faster than many companies expected, rental companies were caught with too few cars to fill their (unexpectedly large number of) customers' needs.[33] According to one industry executive, the "low-inventory, high-price trend started emerging earlier this year in leisure areas including Florida, Arizona and Las Vegas, and then spread to Hawaii, Alaska and national parks."[34] The shortage (and rising prices) is severe enough that some people have started renting U-Haul trucks instead of rental cars, and others are making their vehicles available for rent on peer-sharing platforms, such as Turo.[35]

Making matters worse, pandemic-related disruptions also caused a global semiconductor shortage which, in turn, led to a shortage of *new* cars.[36] Thus, even if car-rental companies wanted to immediately replenish their fleets with new vehicles—unlikely, given the uncertainty regarding future demand from business travelers—they would be unable to do so. As with several other industries, it appears that semiconductor manufacturers were caught off-guard by the pandemic, and the unexpectedly high demand for laptops and tablets contributed to the overall chip shortage.[37] Naturally, many firms were not able to easily meet the increased demand due partly to pandemic-related factory closures.[38] Regardless, the chip shortage caused several car makers to stop production for at least some of their vehicles, and the shortage is likely to affect production throughout 2021.[39]

Food. Perhaps more than many other types of businesses, the government shutdowns negatively impacted restaurants. Not only did the shutdowns cause an enormous drop in their customers, but the pandemic also disrupted the companies that supply restaurants with food. Many restaurants that survived are now experiencing resurgent demand,[40] but they are also faced with higher costs for both food (among other supplies) and workers. Still, the COVID-19 problems experienced across restaurant types—and the food industry, in general—have been far from uniform.

Especially near the beginning of the pandemic, higher prices for *food away from home* were driven by price increases at limited-service restaurants (fast-food establishments).[41] Customers relied heavily on limited-service stores at first, with delivery services contributing to higher prices. Later in the pandemic, as full-service restaurants started reopening, they also began charging higher prices.[42] Broadly, both types of restaurants are facing higher costs for various types of food and supplies (such as gloves, masks, and extra disinfectant), and both are dealing with labor shortages that are causing them to pay higher wages.[43] Many restaurants, from local establishments to chains, such as Chipotle and Cracker Barrel, have increased their menu prices by as much as 5 percent.[44]

For the near future, consumers should probably expect restaurants to charge higher prices *and* to frequently change their menus to substitute for some higher-cost food items.[45] This increased item substitution will be due to pandemic-related disruptions in the industries that supply food to both restaurants and grocery stores. Prior to COVID-19, aggregate U.S. food expenditures were split approximately 54 percent in the restaurant industry and 46 percent in retail grocery stores.[46] When the government shutdowns started, aggregate restaurant expenditures plummeted while spending on food purchased at grocery stores rose.

Even without further COVID-19-related disruptions, this sort of shock to the food industry would likely have caused temporary shortages and higher prices for at least some kinds of food products. The meat industry, for example, consists of beef packers that fabricate beef carcasses into hundreds of different wholesale products, which then move through specialized processing plants that "further expand the set of products by several thousand additional products into largely separate supply chains."[47] Thus, any major shift away from supplying restaurants—or grocery stores—disrupts these supply chains.

Naturally, these beef plants—as well as the slaughterhouses and those plants that process pork and chicken—also suffered problems well beyond having to find new customers. According to the Kansas City Federal Reserve:

> On average, about 10% of employees at beef and pork plants tested positive for COVID-19. At some plants, COVID-19 affected as many as 30% to 70% of the workforce. Almost half of the plants with outbreaks closed for some time.... Most facilities that did were closed for more than one week. Plants that did not close or that reopened after a temporary closure typically slowed operations due to the need for social distancing and other precautionary measures.
>
> Closures and slowdowns led to sharp reductions in operating capacity at beef and pork plants and a significant decline in meat production. As plants were idled or limited operations, daily capacity at U.S. cattle and hog facilities declined as much as 45%.... Reduced capacity at meatpacking plants led to notable reductions in cattle and hog slaughter compared with previous years. Meat production began to decline in early April, and by mid-May, was 40% below 2019 levels.... Even as plants reopened, modified operations and revised processes related to COVID-19 put some constraints on production.[48]

An Oklahoma State University agriculture professor describes a similar situation:

> Never before have so many packing and processing plants been affected simultaneously by reductions in capacity. Some harvesting plants completely shut down for up to 2 wk [weeks] and others curtailed output due to labor force reductions. Cattle slaughter decreased weekly through the month of April, reaching a peak reduction of 34.8% down year over year the end of April, and then slowly recovered through May.[49]

The pandemic similarly affected the poultry industry.[50] Based on reports from Tyson Foods and the United Food and Commercial Workers, which represents 24,000 Tyson workers, the pandemic "devastated meat and poultry packing facilities, forcing temporary closures and causing at least 132 worker deaths."[51] Many plants, where employees tend to work closely together for long hours, were forced to close temporarily when COVID-19 outbreaks hit. Drastic reductions in demand for certain products, along with plant closures, often left producers with no choice but to destroy their livestock, a decision that can magnify both current and future shortages.[52] All these shutdown-related difficulties were further magnified by unusually cold weather in Texas[53] and a cyberattack on one of the largest global meat-processing companies.[54]

Workers. During the pandemic, many companies faced temporary disruptions in the labor force, such as those described above in the meat-packing industry, when workers contracted COVID-19. However, many employers are still facing major labor problems, many of which go well beyond short-term disturbances. In the typical economic downturn, unemployment rises and then falls as the economy recovers and jobs become more plentiful. Moreover, high unemployment is generally accompanied by a low (or declining) number of job openings. Although the U.S. unemployment rate has declined, the labor market recovery from the pandemic has been atypical.

At the height of the pandemic, the unemployment rate exceeded 14 percent, and has since fallen to 5.4 percent. According to the BLS, total employment rose by 943,000 in July, with 326,900 of those job gains occurring in the *accommodation and food services* sector.[55] Yet, the number of unemployed persons remains well above pre-COVID-19 levels. In July 2021, 8.7 million people were unemployed, versus 5.7 million in February 2020. Similarly, the number of people *employed* remains more than 5.5 million below pre-pandemic levels.[56]

Still, the U.S. now has a record number of job openings, along with a record number of workers quitting their jobs, and a record-low number being laid off. By the end of June 2021 (the most current data as of this writing), there were a record-high 10.1 million job openings, an increase of 6.5 percent from May.[57] The last time that the U.S. had a similar unemployment rate (5.9 percent in 2014), there were only 4.9 million job openings in the economy. Thus, whatever problems exist in the labor market, a lack of jobs is not one of them.[58]

Although some people have surely stayed out of the labor force, at least temporarily, due to concerns over COVID-19, there is little doubt that enhanced and extended jobless benefits have contributed to people staying out of work. Congress provided an unprecedented $600 weekly supplement to state unemployment insurance (UI) benefits from March 2020 through July 2020, and an additional $300 weekly supplement from December 2020 through September 2021.[59] Congress added an additional $100 per week on top of other unemployment benefits, available from December 2020 through September 2021, to "mixed earners" who had at least $5,000 of self-employment income in the prior year.[60] Research shows that the initial $600 weekly bonus benefits led to approximately two-thirds of workers receiving more from unemployment than from their previous jobs, and that the $300 weekly bonuses (with up to 18 months' worth of benefits) forced employers to compete with the government to get the workers they needed.[61]

The overall effects of the pandemic-related expansions to UI manifested as an unprecedented surge in UI payments. Normally, about 40 percent of unemployed workers receive UI benefits.[62] Since the pandemic started, however, far more people have received unemployment benefits than have been unemployed. Between April 2020 and May 2021, the number of people receiving unemployment benefits averaged 176 percent of the number of unemployed people.[63]

Even without these outsized expansions, it is uncontroversial that higher benefit levels and longer benefit availability leads to higher unemployment. One of the most recent examples was the 2008 Great Recession. Researchers at the Federal Reserve Bank of New York estimated that the extended UI benefits (up to 99 weeks during that recession) increased the number of unemployed people by 4.6 million in 2010 and by 3.3 million in 2011.[64] As part of the COVID-19 response, Congress extended eligibility for UI benefits from the usual 26-week limit to 79 weeks. Economic studies consistently show that these types of extended benefits lead to longer durations of unemployment.[65] The extra $600 and $300 weekly bonuses during the pandemic would, of course, only be expected to magnify this problem.[66]

The government response to COVID-19 also included other types of economic aid—such as federally financed tax credits, and the Paycheck Protection Program—that provided funds to individuals, families, and businesses.[67] Although some of these programs helped to keep afloat businesses that likely would have otherwise failed, thus preventing many Americans from losing their housing or having essential services cut off, these deficit-financed programs have also left many households with unusually high disposable income.[68]

Per capita disposable personal income, for instance, increased 14 percent from January through March, far greater than the average first-quarter increase (0.43 percent) during the past decade.[69] So far, the recovery funds have mainly boosted personal savings, suggesting that higher consumer spending has yet to occur. For instance, personal savings as a percentage of disposable income averaged 16 percent for 2020, 20.8 percent in the first quarter of 2021, and 10.9 percent in the second quarter. These figures are well above the average (7.3 percent) from 2010 to 2019.[70]

Combined, the pandemic policy responses have created a large group of Americans with more disposable income, putting upward pressure on prices (everything else constant). The policies have also provided many with less incentive to work at pre-pandemic rates, putting upward pressure on wages which, in turn, can put upward pressure on prices. Some recent price increases, such as restaurant prices, are at least partly explained by the extremely tight labor conditions in the U.S.[71]

Container Shipping. Estimates show that approximately 80 percent of all goods traded internationally are carried by sea,[72] and the container shipping industry has not been immune to major disruptions from the pandemic. For instance, a COVID-19 outbreak at one of the world's busiest ports in China (in the city of Shenzhen) brought container traffic to a standstill for weeks.[73] Delays at ports such as these cause major ripple effects, and similar problems have developed at several crucial gateway ports for exporting to the entire world.[74]

According to *The Wall Street Journal*, container shipping prices have surged as much 63 percent since January 2021, and the shipping company Maersk expects the backlog in Shenzhen to "be felt globally, affecting goods sold at Walmart Inc. and Home Depot Inc., companies that have established logistics bases around the port."[75] In fact, Shenzhen is in China's most populous province, Guangdong, and is responsible for approximately one-tenth of China's economic output—goods which have previously helped hold *down* consumer prices in many countries, including the U.S.[76]

Lumber. Early in the pandemic, the producers of residential construction materials, including lumber, expected a declining housing market and decreased demand. In March 2020, housing starts fell by 22.3 percent and in response to the slowdown, lumber mills idled or curtailed production. However, in June 2020, demand from the residential construction sector rose unexpectedly fast, resulting in lumber shortages.[77] The industry tried to meet demand by reopening mills and expanding production, but demand has continued to exceed supply, maintaining shortages and the corresponding price increases.[78] Although the commodity price of lumber increased nearly threefold during the pandemic, it has declined rapidly since May 2021 and is now near its pre-pandemic level.[79]

Policies Don'ts—and Do's—for Federal Officials

Recent CPI increases have many Americans worried about high inflation, and these fears are perfectly understandable, especially because higher food and gasoline prices have been two of the key drivers of the CPI surge. Still, these individual price increases *themselves* are not inflation, which is a persistent rise in the general level of prices.[80] Naturally, consumers do not care about such technical definitions of inflation—they dislike having to pay higher prices.

Regardless of technical definitions and economists' current inflation forecasts, policymakers should not dismiss consumers' inflation concerns, as expectations of higher inflation could, in fact, lead to a persistent increase in the overall CPI.[81] Additionally, if policymakers respond inappropriately to the recent price increases, they could mistakenly worsen the economic problems that Americans are now facing and prolong the recovery. Pandemic-related disruptions have been driving price increases in specific market segments, and policies that fail to mitigate those specific disruptions run the risk of making it even more difficult for people to get the goods and services that they need. The following list provides several policies that federal officials should avoid, as well as some that it should enact, to speed up the economic recovery:

***Do Not* Pass More Deficit-Financed Spending Bills.** The fact that the CPI has been increasing after large increases in federal deficit spending has added to the public's inflation fears. Prior to President Joe Biden's recent $1.9 trillion COVID-19 relief package, the federal government had already increased the national debt by $4.5 trillion in 2020.[82] Even without this new package, the Congressional Budget Office estimates that the federal deficit in 2021 will be "the second largest since 1945, exceeded only by the 14.9 percent [of GDP] shortfall recorded last year," and that publicly held federal debt will reach 102 percent of GDP by the end of 2021.[83] In February, the $1.9 trillion package drew a mild rebuke from economist Lawrence Summers (an advisor to both the Clinton and Obama Administrations), who argued that the new relief package appeared too large relative to the current economic shortfall. Summers warned that a spending plan so large could "set off inflationary pressures of a kind we have not seen in a generation, with consequences for the value of the dollar and financial stability."[84]

Soon after this warning, the Biden Administration announced two *new* spending proposals totaling an additional $4.5 trillion,[85] and Congress is now set to vote on a $1 trillion infrastructure bill before turning to a (broader) $3.5 trillion spending bill.[86] The recognition that persistently high levels of debt and deficit spending can lead to inflation and economic instability is hardly new,[87] and it is rooted in the classic "too many dollars chasing too few goods" phenomenon. Any new deficit spending programs—even under the name "infrastructure"— will increase inflationary pressures because they will provide people with additional funds to bid for the same amounts of physical resources.[88] That is, these programs will not alleviate shortages by creating more livestock and gasoline, nor by increasing the number of workers. They will, instead, provide people with more funds to pay suppliers who still face many of the same constraints that caused the shortages in the first place. Given that prior stimulus bills have left so many households with unusually high disposable income levels, and that employers are having a difficult time hiring the workers they need, the normal justification for these kinds of spending programs does not exist. There is no lack of consumer demand or job opportunities, so additional deficit spending will do little more than lead to upward pressure on prices.

***Do Not* Shrink the Money Supply.** The Federal Reserve is now facing a common problem for inflation-targeting central banks: When an economy is hit with damaging supply shocks, such as government shutdowns and shortages due to a pandemic, sticking to an inflation target requires the central bank to intervene in a counterproductive way. Just like damaging slowdowns in trade, such as the oil embargo in the 1970s, these kinds of supply shocks lead to higher prices due to fewer goods and services in the economy. If these shortages cause prices to rise above the Federal Reserve's inflation target—a danger during the present COVID-19 recovery—it leaves the central bank in the unenviable position of trying to lower the rate of inflation by *decreasing* the amount of money in the economy.

The problem, though, is that shrinking the money supply (tightening the Fed's policy stance) in these circumstances would starve the economy *even further*. In other words, by pursuing price stability in the face of a negative supply shock, the Fed would provide even less money to purchase even scarcer items, thus making it more difficult for people to buy the goods and services they need.[89] It would make little sense, of course, to shrink the money supply for the sake of hitting an inflation target while the economy is collapsing due to shortages.[90] The Fed should not tighten its policy stance for the sake of hitting an inflation target until the economy has recovered—the Fed should only shrink the money supply to correspond to a decrease in the demand for money.

***Do* Lift COVID-19 Restrictions and Promote Vaccines.** COVID-19 created a global pandemic, infected over 35 million Americans, and claimed the lives of over 600,000.[91] Although the data clearly show that vaccines have reduced the risk of serious illness and death from COVID-19 to near-zero, and made infection much less likely, public officials have continued to confuse Americans by providing conflicting messages, often unconnected to any supporting data.[92] Throughout the pandemic, in fact, government officials have stubbornly promoted uniform policies of widespread lockdowns, shunning policies tailored to the age-related risk disparities of COVID-19.[93] They have pushed a distorted view of COVID-19 risk on tens of millions of Americans, stoking a climate of fear instead of rationality.[94] Even now, many public officials seem incapable of distinguishing between the risk of getting infected and the risk of serious illness and death—which is predominantly a problem among the unvaccinated.[95] Not only has this failure needlessly created widespread panic, it has slowed down, and sometimes prevented, the provision of more targeted public health interventions needed by those most at risk. Government officials should stop politicizing the pandemic: They should lift COVID-19 restrictions, promote vaccines, and provide targeted public health solutions to those most at risk.

***Do* Lower Tariffs and Trade Restrictions.** International trade is generally driven by the ability of people in various countries—through comparative advantages—to deliver lower-priced goods to consumers.[96] The pandemic has disrupted trade and contributed to higher prices for many goods. If policymakers want to lower consumers' costs, they can encourage more trade by eliminating tariffs and non-tariff barriers. Between 2018 and 2020, for instance, Americans paid $7.5 billion in extra steel tariffs.[97] Tariffs on specific items can even raise prices of complementary goods, thus resulting (everything else constant) in fewer consumer purchases of multiple products. Research shows, for instance, that the price of washing machines rose by nearly 12 percent in response to the 2018 tariffs, and that "the price of dryers—a complementary good not subject to tariffs—increased by an equivalent amount."[98] Congress and the Administration should promote freer trade by reducing both tariff and non-tariff barriers.

***Do* Reduce Regulations and Government Barriers to Economic Opportunity.** Numerous government regulations exist that drive up consumer prices, including those for food and energy. Many of these policies disproportionately hurt the poor, even during normal times when people are not struggling to deal with pandemic-related economic problems. Thus, if Congress is concerned with higher consumer prices, now is the perfect time to start eliminating the countless government-imposed economic roadblocks that put upward pressure on prices. For instance, the federal government regulates a long list of consumer and commercial appliances, including refrigerators, air conditioners, furnaces, televisions, shower heads, ovens, toilets, and light bulbs. These regulations prioritize efficiency over other preferences that customers and businesses might have, such as safety, size, durability, and cost.[99] The renewable fuel standard, passed in 2005 and expanded in 2007, mandates that billions of gallons of ethanol (primarily corn-based ethanol) be blended into gasoline and diesel each year—a requirement that, according to the Government Accountability Office, pushes fuel prices higher for limited, if any, environmental or climate benefit.[100] Moreover, using crops to make fuel can result in additional scarcity (and higher prices) in food markets.[101]

In some cases, Americans are still paying for bad policies enacted decades or even more than a century ago—the Jones Act, for instance, was passed in 1920 and mandates that any goods shipped by water between two points in America must be transported on a U.S.-built, U.S.-flagged vessel with a crew that is at least 75 percent American. By preventing foreign competition, the Jones Act drives up costs for no material economic or national security benefit.[102] As professor James Coleman has pointed out, due to these requirements, "northeastern U.S. refineries pay more than three times as much to ship oil from Texas rather than from West Africa or Saudi Arabia."[103]

Congress can also enact policies that unleash America's energy resources, allowing private businesses to produce more energy, placing downward pressure on prices. For example, Congress can allow open access to energy exploration of federal waters and lands, expand free trade for energy sources, and eliminate all regulations (and taxes) that discourage the use of conventional fuels.[104] Congress should also curb regulatory abuses by the current Administration, which is restricting access to energy resources and increasing the costs of energy through policies such as canceling the Keystone pipeline and placing a moratorium on oil and gas permitting on federal lands.

***Do* Normalize Monetary Policy.** The Federal Reserve and Congress have breached the traditional boundaries between the monetary and fiscal authorities, thus making it easier to engage in strictly fiscal quantitative easing operations, the type of financing favored by supporters of (inherently inflationary) large-scale infrastructure projects and helicopter money proposals, both of which tend to be inflationary.[105] The risk of a fiscal crisis and higher inflation are heightened by persistently increasing debt and deficits. Such a fiscal path ultimately causes people to lose confidence in the nation's ability to service debt. Similarly, people lose confidence in the ability of the United States to finance deficits as the Fed purchases a higher and higher share of outstanding Treasury debt. Regardless of the recent CPI figures, elected officials should curb rising U.S. debt and the growth in entitlement spending.[106] If the Fed does not revert to its traditional (pre-2008) operating framework on its own, Congress should require the Fed to do so over a specific period. The current operating framework politicizes monetary policy and endangers the Fed's (already imperfect) ability to control inflation. The Fed could also help to calm the public's fears by stating, for example, precisely which time period it will use to target 2 percent inflation.

***Do* Use More Accurate Inflation Measures.** Evidence suggests that the measures of chained indexes, such as the Personal Consumption Expenditures (PCE) index and the chained CPI-U, are superior to the non-chained CPI measure along several dimensions, such as capturing consumer substitution biases or changes in consumers' year-to-year consumption patterns.[107] While it is well-documented that *both* the PCE and CPI suffer from biases that tend to *overstate* inflation, research also shows that the non-chained CPI tends to overstate inflation more than the PCE or the chained CPI-U.[108] While the federal government still uses the CPI for Urban Wage Earners and Clerical Workers (CPI-W) or the CPI-U to adjust Social Security benefits and many other spending programs for inflation, the Federal Reserve and the Congressional Budget Office rely on the PCE to make inflation adjustments.[109] In 2017, Congress updated the tax code to use the more accurate chained CPI-U as a part of the Tax Cuts and Jobs Act. Congress should update all spending programs to use more accurate measures of inflation, such as the chained CPI-U, which would ensure that benefit increases more accurately reflect changes in the cost of living while protecting taxpayers from overpaying.[110]

Conclusion

Even though individual price increases themselves do not represent inflation, the recent surges in the CPI—driven by prices in a few specific sectors—demonstrate just how much consumers dislike paying higher prices. Still, if policymakers respond inappropriately to these recent price increases, they will likely worsen the economic difficulties that Americans now face, prolonging the recovery. Specifically, it would be improper for the Federal Reserve to immediately tighten its policy stance for the sake of hitting an inflation target, and it would be a mistake for Congress to enact new deficit-financed spending proposals.

The economy is now recovering from a massive supply shock, one that created shortages of all kinds of goods and even workers. Shrinking the money supply in these circumstances would starve the economy *even further*. Separately, previous stimulus bills have left many households with abnormally high levels of disposable income, and employers are having a difficult time finding the workers that they need. These new spending programs will not alleviate shortages by creating more livestock or gasoline, or by increasing the number of workers in the economy—they will create inflationary pressures because there is no dearth of consumer demand or jobs.

Pandemic-related disruptions have been driving price increases in specific market segments, and policies that fail to alleviate those specific disruptions run the risk of making it even more difficult for people to get the goods and services that they need. If Congress is truly concerned about high prices, especially those for food and energy, now is the perfect time to start eliminating the countless government-imposed economic roadblocks that already create upward price pressures.

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Endnotes

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4. These figures represent the changes between April 2019 and April 2020, and so on.
5. Without rounding, the average annual changes for April, May, and June (from 2000 to 2019) were 2.142 percent, 2.135 percent, and 2.106 percent, respectively. Author's calculations using the CPI-U, All Items, seasonally adjusted. The standard deviations for the same categories were 1.15 percent, 1.29 percent, and 1.42 percent, respectively. Thus, the 2020 increases were less than expected (especially for April and May) based on the normal annual variation in the CPI.
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10. In June, transportation services (including an 87.7 percent increase in car-rental rates) explained 10 percent of the CPI increase.
11. The BLS data also show that gas prices suffered a steep decline at the beginning of 2020, to nearly a four-year low, when they declined 30 percent from January to April. See Michel, "Inflation and the Fed: How Congress Should Approach Monetary Policy." Used-car prices followed a mild downward trend (approximately 2.5 percent) through the first six months of 2020, while car-rental prices fell almost 30 percent between December 2019 and May 2020.
12. Similar to the annual CPI changes reported in May, the main subcategories for prices on *food away from home* show that *full-service meals* are responsible for 2.4 percent of the increase, while *limited-service meals* account for 3.1 precent. Full-service meals refer to dine-in restaurants, whereas *limited-service meals* refer to fast-food establishments. Prices in the *food away from home* category did not show a decline in 2020 on either an annual or monthly basis.
13. It also appears that restaurant owners are dealing with similar issues. That is, even though wholesale food prices, overall, do not display an abnormal spike in 2021 (wholesale food prices are on an increasing trend since 2013), the prices of *certain types* of foods have shown abnormal price increases. See Olivia Rockeman, Leslie Patton, and Michael Sasso, "Inflation on the Menu as U.S. Restaurants Pass On Soaring Costs," Bloomberg, June 23, 2021, https://www.bloomberg.com/news/articles/2021-06-23/u-s-restaurants-boost-menu-prices-at-fast-clip-to-recoup-costs (accessed August 2, 2021). For wholesale food prices, see U.S. Bureau of Labor Statistics, "Producer Price Index by Commodity: Wholesale Trade Services: Food Wholesaling [WPU578101]," retrieved from FRED, Federal Reserve Bank of St. Louis, https://fred.stlouisfed.org/series/WPU578101 (accessed August 2, 2021).
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17. The same pattern was seen in March for the previous two years, and at least some of the 2021 increase is explained by basic supply-and-demand factors separate from any recent policy changes. Nicolas D. Loris, "Rising Gas Prices: A Look Under the Hood," Heritage Foundation *Commentary*, March 26, 2021, https://www.heritage.org/energy-economics/commentary/rising-gas-prices-look-under-the-hood. Also, on a calendar-year basis (from January to December), between 1990 and 2020, U.S. gas prices have typically fluctuated 19 percent, with a decrease of 44 percent in 2008 and an increase of 48 percent in 2009. See Michel, "Inflation and the Fed."

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