Recent Causes of Inflation and Adverse Consequences for Consumers

American Consumer Institute
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The American Consumer Institute
Center for Citizen Research

Recent Causes of Inflation and Adverse Consequences for Consumers

Executive Summary

Consumers agree that the biggest problem facing the United States is inflation, as record price increases have made it harder for families to make ends meet. This report outlines the factors that created an inflationary spiral and what can be done to help lower prices for consumers. The report's highlights include:

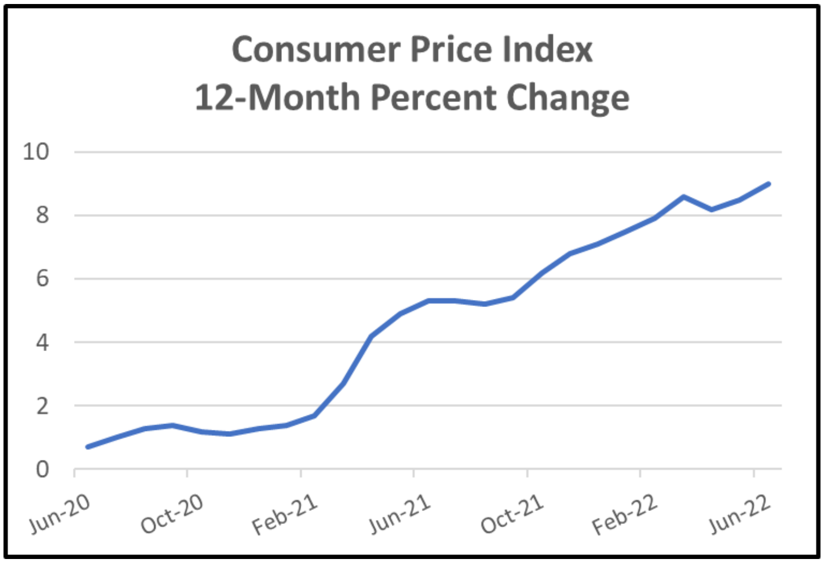
- Increased government spending and stimulus checks have created more demand than supply, leading to demand-pull inflation;
- Energy prices surged as projects have been shelved, and the regulatory environment has become increasingly less conducive to domestic production, thereby leading to cost-push inflation;
- Low-income consumers are disproportionately hurt by higher prices, as the increase in energy and transportation prices alone will cost households earning less than $15,000 per year nearly $1,000 more in 2022; and
- Increases in various general regulations have increased operational costs for businesses, and the potential for increased taxes will increase consumer costs of food and other goods.

The combination of increased spending, energy shortages, and increased regulations have led to increases in inflation that have far outpaced wage increases. Based on our analysis and those of others, consumers are likely to lose thousands of dollars this year alone — by one measure, $4,400 per household in 2022 — disproportionately hurting poorer Americans and those on fixed incomes. Fortunately, inflation is likely to slow a bit with the recent easing of commodity prices and a decrease in gas prices at the pump. However, continued spending on the legislative agenda does not bode well for keeping inflation to a minimum.

With higher interest rates to cool excessive demand, policy solutions are necessary to cut onerous regulations, encourage domestic energy production, and contain future government spending and tax increases. These actions will help reduce high inflationary over the next year.

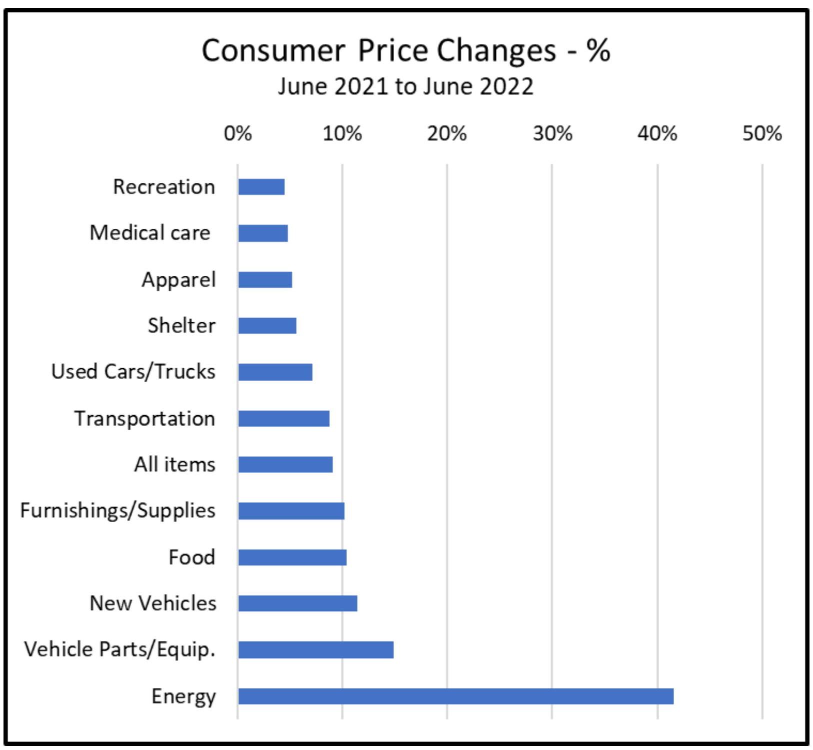
The Inflationary Spiral

After a decade of inflation running around an annualized rate of 2%, the spring of 2021 brought a marked increase in consumer prices that has since accelerated. In July 2022, the Bureau of Labor Statistics found that prices across the economy over the last 12 months have increased by 9.1% -- the most significant increase in 40 years.



Source: Bureau of Labor Statistics

Within the market basket of consumer purchases, some categories have experienced rapid price increases over the past year. The chart below shows that the price surge has been most evident in energy, transportation, food, household furnishing and supplies, and motor vehicles.



Source: Bureau of Labor Statistics

Over the last year, the price of gasoline spiked 59.9%, airfare increased 34.1%, new vehicles jumped 11.4%, and used cars rose 7.1%. Also noteworthy is the price of electricity, groceries, and rent, which have climbed 13.7%, 12.2%, and 5.6%, with this year ringing in the most significant cost increases for consumers since 1986. As prices escalate, millions of Americans will be forced to make tough financial choices.

High inflation erodes worker wages, trims savings, and reduces consumer purchasing power. Diminished purchasing power explains, in part, why higher prices disproportionately harm low-income Americans, as well as those who are on fixed incomes, like retirees.

Despite a modest decline in gas prices, inflationary pressures appear to be "baked" into the current economic cycle and not are transitory, as some previously claimed.[1] Promisingly, with the recent easing of commodity prices and the decline in prices at the gas pump, the rate of inflation will likely decrease, albeit temporarily, but remain above average in the near term. While we expect above-average inflation to continue, barring a recession, the prospects for future spending initiatives and tax increases will unequivocally exacerbate the inflationary spiral and further ratchet up consumer prices.

The Federal Reserve has little choice but to hike interest rates to cool demand and end the current inflationary spiral.[2] Unfortunately, such actions could make it challenging to achieve a "soft landing" and are equally likely to usher in a national recession, leading to job losses and harming Americans of all incomes. Not surprisingly, gross domestic product, the most comprehensive measure of economic output, has fallen for two consecutive quarters, driven primarily by falling investment, declining discretionary income, and five straight quarters of declining disposal income.[3] The Federal Reserve has its work cut out for it, particularly if Congress continues its appetite for excessive fiscal spending.

This report will explore the principal drivers of inflation in the American economy, how it hurts consumers, and what the legislative and executive branches can do to mitigate its effects.

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[1] Joe Biden, "Remarks by President Biden on the Economy," White House Briefing Room, May 10, 2022, https://www.whitehouse.gov/briefing-room/speeches-remarks/2022/05/10/remarks-by-president-biden-on-the-economy-5/.

[2] Nick Thomas, "Fed Lifts Rates by 0.75 Point Again," *The Wall Street Journal*, July 28, 2022; and Paul Davidson, "Federal Reserve increases key interest rate by 0.75% in biggest hike since 1994. What's that mean for the economy and you?" *USA Today,* June 16, 2022, https://www.usatoday.com/story/money/2022/06/15/fed-interest-rates-hike/7631195001/.

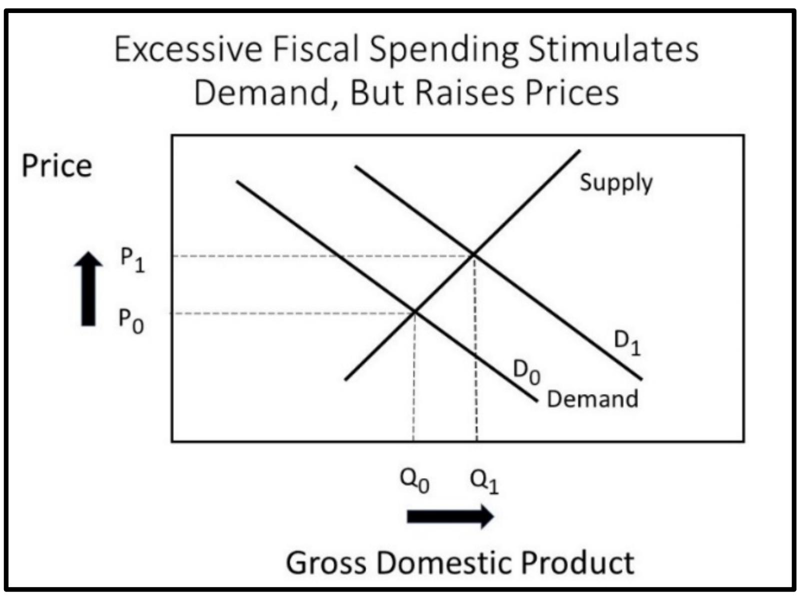
[3] "Gross Domestic Product, Second Quarter 2022 (Advance Estimate)," U.S. Department of Commerce's Bureau of Economic Analysis, July 28, 2022, https://www.bea.gov/sites/default/files/2022-07/gdp2q22_adv.pdf.

Inflation Through Government Stimulus

Government officials can undertake monetary and fiscal stimulus to boost economic output and create jobs. While fiscal stimulus can be useful in helping the economy rebound, it can also result in price increases for consumers. As such, lawmakers must be aware of the broader effects of their decisions.

A case in point is the unprecedented level of government spending over the last two years. As economic activity shut down during the COVID-19 pandemic, Congress passed a series of economic rescue plans, costing nearly $6 trillion, far surpassing any previous federal spending initiative. These stimulus packages were successful insofar as they put money in people's pockets during COVID lockdowns. However, as the economy rebounded, the excess cash meant that "too much money was chasing too few goods."

Economists refer to instances where fiscal stimulus leads to demand growth that exceeds supply (total capacity) as *demand-pull inflation*. As the chart below shows, increased fiscal spending will increase demand (shift the demand curve from D_0 to D_1) which will lead to higher levels of economic output (an increase from Q_0 to Q_1), but it also results in higher prices (an increase from P_0 to P_1). While some financial relief may have been necessary early on, given high unemployment, the excessive level of government spending led to significant inflation.



An assessment of the COVID rescue plan spending by the non-partisan Congressional Budget Office (CBO) concluded that "fiscal stimulus is more likely to bid up the price of those resources—resulting in inflationary pressure" in the economy.[4] The CBO, however, failed to

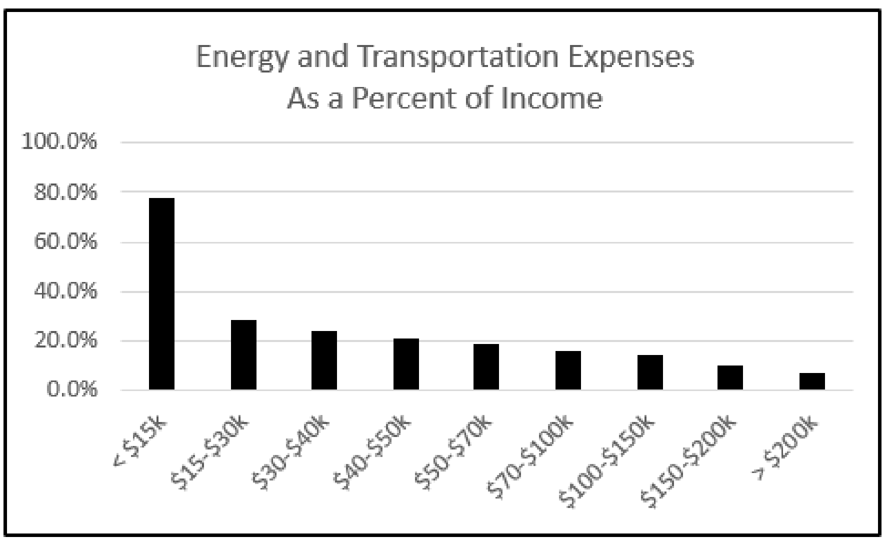
[4] "The Effects of Pandemic-Related Legislation on Output," Congressional Budget Office, September 2020, https://www.cbo.gov/publication/56597.

predict that inflation would reach record levels, suggesting other factors may have also contributed to inflationary pressures in the U.S. economy.

Fueling Input Costs Through Shortages

Rising prices result in conditions in which demand for a product is stable, but production costs are higher, such as during a shortage of input factors. Economists refer to this price pressure as *cost-push inflation* – which is a simple distillation of what has been and still is occurring in the energy sector. Energy has become the principal driver of inflationary pressure in the American economy. In June 2022, the Bureau of Labor Statistics reported that energy prices were up 41.6%, while the average cost of all indexed goods was up 9.1%, as noted early.[5] The principal reason for rising prices is that energy resources – such as offshore drilling and fracking – were constrained due to public policy.

Inflated energy prices disproportionately hurt low-income Americans, whose energy and transport costs amount to nearly 80% of household income for those earning less than $15,000 per year. For those earning over $200,000, energy and transportation costs account for less than 10% of their income. When energy prices are high, the poorest among us face the greatest financial strain.



Source: Bureau of Labor Statistics

High energy prices do not just affect low-income Americans; they also harm economic output, thereby slowing consumer expenditures. For example, the National Bureau of Economic Research found high inflation cut production by $26 billion in 1974 and $63 billion in 1975.[6] The

[5] "Consumer Price Index, June 2022," Department of Labor, Bureau of Labor Statistics, https://www.bls.gov/cpi/.
[6] Knut Anton Mork and Robert E. Hall, "Energy Prices, Inflation, and Recession, 1974-1975," *National Bureau of Economic Research*, July 1979, p.33, https://www.nber.org/system/files/working_papers/w0369/w0369.pdf.

bureau also found that consumption decreased by 3.3% each year due to high energy prices.[7] Significant cost increases for energy and fertilizer have also driven up the price of agricultural products, impacting a wide range of grocery items, including poultry and livestock.

Given how vital energy prices are to the broader economy's health, government officials and the administration should prioritize policies that keep energy prices low. Yet, several actions by this administration have resulted in increased costs and a strain on American families.

Most notably, the administration revoked a critical permit needed for the Keystone XL pipeline that was projected to carry 830,000 barrels of oil per day from Alberta, Canada to Nebraska.[8] The pipeline's cancellation coincided with a steep decline in U.S. oil production. Indeed, last month the Energy Information Administration (EIA) reported a 0.5% decline in oil production, the lowest production rate since February.[9] Such a decline in supply has inevitably resulted in higher energy prices for American consumers.

The administration has also failed to provide the necessary permits for oil drilling and fracking, in line with a campaign promise to make America carbon neutral.[10] In 2020, the federal government approved 4,631 drilling applications.[11] Despite reaching record approvals in April 2021, the Bureau of Land Management only approved 117 permits in January 2022.[12] Just 162 drilling permits were approved in May, well below previous years.[13]

The administration has empowered federal agencies to be more aggressive with their enforcement efforts. For instance, the Environmental Protection Agency (EPA) recently announced it might soon designate significant parts of the energy-rich Permian Basin in New Mexico and Texas as off limits to fracking due to concerns about air quality.[14] The Permian Basin alone is responsible for 43% of U.S. oil production due to extensive oil shale deposits.[15] With fewer permits for drilling being approved on oil-rich federal lands and more hoops to

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[7] Ibid.
[8] "What Is the Keystone XL Pipeline?" Natural Resources Defense Council," March 15, 2022, https://www.nrdc.org/stories/what-keystone-pipeline.
[9] "Monthly Crude Oil and Natural Gas Production," U.S. Energy Information Administration, https://www.eia.gov/petroleum/production/.
[10] Bobby Magill, "Interior Issuing Fewer Oil Drilling Permits with Climate Pivot," *Bloomberg Law*, September 24, 2021, https://news.bloomberglaw.com/environment-and-energy/interior-issuing-fewer-oil-drilling-permits-with-climate-pivot.
[11] "Application for Permit to Drill Status Report: Fiscal Year 2020," Bureau of Land Management, https://www.blm.gov/sites/blm.gov/files/docs/2021-03/APD%20Status%20Report%20FY%202020.pdf.
[12] https://www.blm.gov/sites/blm.gov/files/docs/2022-03/FY%202022%20APD%20Status%20Report%20Jan.pdf.
[13] https://www.blm.gov/sites/blm.gov/files/docs/2022-06/FY%202022%20APD%20Status%20Report%20May.pdf.
[14] The Editorial Board, "Biden's Raid on the Permian Basin," *The Wall Street Journal,* July 29, 2022, https://www.wsj.com/articles/the-epas-de-facto-fracking-curb-permian-basin-environmental-protection-agency-ozone-11656109324?st=l1h1ovvisj24xyt&reflink=desktopwebshare_permalink.
[15] David Blackmon, "EPA Targets Permian Basin, Widening Biden's War on Oil and Gas," *Forbes*, July 1, 2022, https://www.forbes.com/sites/davidblackmon/2022/07/01/epa-targets-permian-basin-widening-bidens-war-on-oil-and-gas/.

jump through for oil and gas companies, the federal government actions are constraining supply, increasing the prices Americans pay for energy.

However, pipelines and drilling permits do not tell the whole story. President Biden has also made transitioning the American economy to renewable energy a cornerstone of his plan. This agenda has pressured the states to conform to federal objectives and propose their own green energy initiatives. In some cases, states have even pressured utilities to close coal and nuclear plants before viable alternative green energy sources can be identified and built. The Indian Point Nuclear Plant closure in New York is a case in point.[16] These premature plant closures have forced states to rely more on intermittent energy sources like solar and wind, resulting in higher prices for consumers and placing significant sections of the nation's electric grid at risk of blackouts.[17] These higher prices further fuel inflation.

The administration has correctly pointed out that high fuel prices are partially beyond its control. However, that does not absolve the administration of its contribution to higher prices. The cancellation of pipelines, rejection of oil and gas permits, and promotion of stringent environmental rules and regulations contributed to higher energy prices for American families.

Regulations Can be Costly

Inflationary pressures have also resulted from increased levels of government regulation, which have raised business costs and constrained supply, a process consistent with long-accepted economic thought.[18] Unfortunately for American consumers, the administration has shown a desire to regulate American companies further – having imposed 3,257 new rules by the end of 2021.[19]

According to the U.S. Chamber of Commerce, federal regulations cost the economy $1.9 trillion annually in lost productivity.[20] This is because regulations force companies to spend more money to comply with more rules to produce the same output level. The American Action Forum found similar results, suggesting that just 352 regulations proposed by the administration would cost American companies $214.6 billion.[21] Such expenditures on

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[16] Patrick McGeehan, "Indian Point Is Shutting Down. That Means More Fossil Fuel," *The New York Times*, April 12, 2021, https://www.nytimes.com/2021/04/12/nyregion/indian-point-power-plant-closing.html.
[17] Peter Behr and Jason Plautz, "Grid monitor warns of U.S. blackouts in 'sobering report'," *E&E News*, May 19, 2022, https://www.eenews.net/articles/grid-monitor-warns-of-u-s-blackouts-in-sobering-report/.
[18] Murray L. Weidenbaum, "Government Mandated Price Increases: A Neglected Aspect of Inflation," American Enterprise Institute, February 1975.
[19] Clyde Wayne Crews Jr., "Joe Biden's Year in Federal Regulation, 2021," *Forbes*, December 31, 2021, https://www.forbes.com/sites/waynecrews/2021/12/31/joe-bidens-year-in-federal-regulation-2021/?sh=47b11d356240.
[20] "Understanding Small Business in America," U.S. Chamber of Commerce Foundation, https://www.uschamberfoundation.org/smallbizregs/.
[21] Dan Goldbeck and Dan Bosch, "Another Energy Efficiency Rule Pops Up," American Action Forum, June 6, 2022, https://www.americanactionforum.org/week-in-regulation/another-energy-efficiency-rule-pops-up/.

complying with federal laws squander precious resources and result in higher costs that are ultimately passed along to consumers in the form of higher prices.

In 2016, the Mercatus Center drew a direct link between government regulation and inflationary pressures, showing that "a 10 percent increase in total regulations leads to a 0.687 percent increase in consumer prices."[22] Highlighting the inverse relationship and supplementing the theory that regulation increases costs for consumers, Robert W. Crandall of the Brookings Institute found that "since the 1970s, deregulation has succeeded in increasing overall economic welfare and sharply reducing prices, generally by about 30 percent, for transportation—including air travel, rail transportation, and trucking—and natural gas and telecommunications."[23]

Understanding this relationship is crucial because it shows that cutting unnecessary, burdensome, and outdated regulations will lower prices for American consumers.[24] On the other hand, increasing regulation creates high compliance costs and operational inefficiencies that translate directly into higher prices and inflation.[25]

For lawmakers and the executive branch, removing outdated, obsolete, and unnecessarily burdensome regulations could be a simple way to reduce inflationary pressures on the U.S. economy. Congress could take the lead by requiring the executive branch to implement a "One-In, Two-Out" policy whereby the removal of two rules must accompany every new regulation. Such a rule, when used in the past, was estimated by the Office of Management and Budget to have saved "American families and businesses $23 billion."[26]

Wages Have Not Kept Up with Inflation

As inflation has accelerated, wages have fallen behind, an indication that workers are losing their purchasing power. The chart below shows that real (inflation-adjusted) hourly

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[22] "Dustin Chambers and Courtney A. Collins, "How Do Federal Regulations Affect Consumer Prices? An Analysis of the Regressive Effects of Regulation," The Mercatus Center*,* February 2016, p. 20, https://www.mercatus.org/system/files/Chambers-How-Regs-Affect-Prices-v2.pdf.

[22] Reducing Regulation and Controlling Regulatory Costs," *Federal Register*, "January 30, 2017, https://www.federalregister.gov/documents/2017/02/03/2017-02451/reducing-regulation-and-controlling-regulatory-costs.

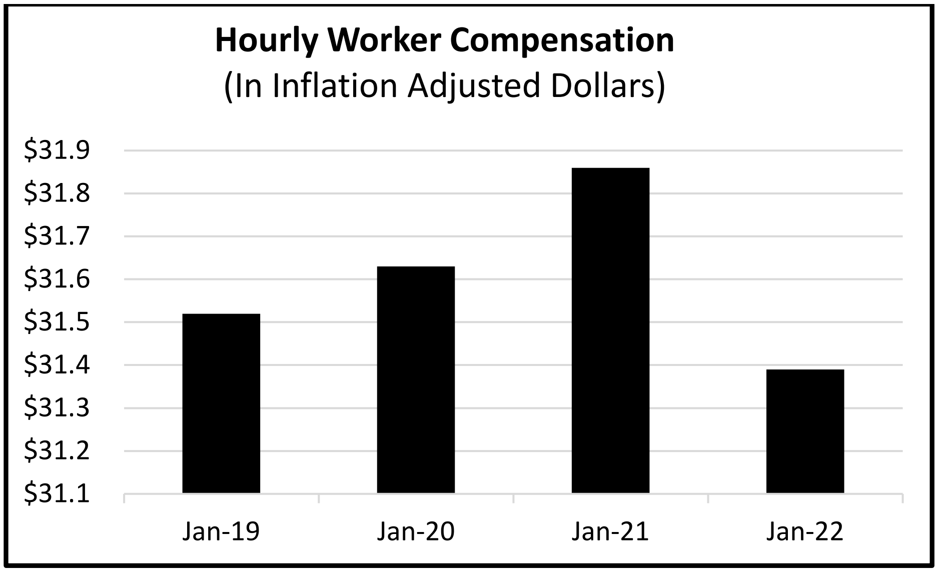
[23] Robert W. Crandall, "Extending Deregulation: Make the U.S. Economy More Efficient," in *Opportunity 08: Independent Ideas for America's Next President* ed. Michael E. O'Hanlon, (Washington D.C.: Brookings Institution Press, 2000), 249.

[24] Dustin Chambers and Courtney A. Collins, 2016.

[25] Weidenbaum, 1975.

[26] *"Executive Order 1377 of January 30, 2017: "Reducing Regulation and Controlling Regulatory Costs," Federal Register.* Available Online: https://www.federalregister.gov/documents/2017/02/03/2017-02451/reducing-regulation-and-controlling-regulatory-costs;The White House, "Regulatory Relief Efforts Deliver $23 Billion In Regulatory Cost Savings," October 17, 2018, https://trumpwhitehouse.archives.gov/briefings-statements/regulatory-relief-efforts-deliver-23-billion-regulatory-cost-savings/?utm_source=twitter&utm_medium=social&utm_campaign=wh.

worker compensation has decreased this year.[27] This means that, employee wages, salaries, and other compensation are not increasing as fast as inflation and purchasing power is decreasing – all evidence of inflation's damaging effect on workers.



Source: Bureau of Labor Statistics

A careful look at the month-to-month data show that average weekly wages for all private-sector employees have fallen after adjusting for inflation, as shown below.

Source: Bureau of Labor Statistics

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[27] Data from the Department of Labor and Bureau of Labor Statistics can be found online at https://data.bls.gov/PDQWeb/ce.

Specifically, the chart shows that real wages have decreased nearly every month over the last 18 months since the surge of inflation began. These data, shown in the chart above, provide further evidence that workers are struggling to keep up with inflation.[28] When real wages fall, consumer purchasing power weakens, making it much harder for families to make ends meet.

As noted here, the most recent data from the U.S. Bureau Labor Statistics show that real compensation and real wages have declined in the wake of rising prices. Based on the empirical evidence, workers and American families have clearly become the casualties of runaway inflation.

Impact on Consumers is Real

The national impact of these factors on consumers cannot be overstated. Excessive government spending, poor energy policy, and costly government regulations have increased prices for every American. According to calculations produced by Moody Analytics and first reported by the New York Post, the average American household is now paying nearly $500 more in monthly expenses than they did back in 2018 and 2019, when inflation stood at only 2.1%.[29] Similarly, the Joint Economic Committee Republicans found that consumer prices increased by 13.3% for the first six months of the year, equal to an average household increase of $718 for just the month of June.[30]

Inflated prices ultimately mean that American consumers have less disposable income than they had previously. With revenues down in real terms, Americans have less money to spend on consumer goods and must devote an even greater share of their paychecks to necessities. As the table below shows, if we assume that energy costs run 40% higher and transportation prices run 9% higher for the entire year, the annual effect on households for energy and transportation will result in thousands of dollars of additional expenses per household, and disproportionately impact those with the lowest incomes.[31]

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[28] Ibid.

[29] Thomas Barrabi, "Inflation Costing Americans Nearly $500 Extra Per Month, Analysis Shows." *New York Post*, July 13, 2022, https://nypost.com/2022/07/13/inflation-cost-americans-nearly-500-extra-in-june-analysis/.

[30] "State Inflation Tracker: June 2022," Joint Economic Committee Republicans, July 13, 2022, https://www.jec.senate.gov/public/index.cfm/republicans/analysis?ID=CD10FBEF-745A-407B-B118-80D18508F7B2.

[31] Data based on Consumer Expenditure Survey for 2020 and comes from the Department of Labor's Bureau of Labor Statistics. Consider these estimates to be conservative, since bringing the data closer in line with 2022 estimates, the dollar impacts shown here would have certainly been higher.

Energy and Transportation Burden From Inflation – Annual Effect

Household Income	Added Cost
< $15k	$ 964.53
$15-$30k	$ 1,074.83
$30-$40k	$ 1,301.06
$40-$50k	$ 1,400.14
$50-$70k	$ 1,618.68
$70-$100k	$ 1,858.31
$100-$150k	$ 2,266.22
$150-$200k	$ 2,311.04
> $200k	$ 2,994.98

Source: Consumer Expenditure Survey, BLS, ACI estimates

Another way to estimate the economic cost of inflation on families is to look at the decline of real wages. As shown earlier, real wages have declined since the beginning of the uptick in inflation. Based on the data since January 2021, real wages have fallen 6.2% over the last 18 months, 4.4% over the previous year, and 3.2% over the last six months. Assuming only a 3.2% impact in lost purchasing power, multiplied by the approximate level of personal consumption expenditures for 2022 — roughly 17 trillion dollars[32] — the average U.S. household will lose nearly $4,400 by the end of the year.

In summary, the cost of inflation is high, and its impact on businesses and the economy is readily apparent. The effect on families is harsh and acute.

Recommendations

When seeking to address inflation, Congress and the White House must take two tracks. First, they must take steps to alleviate cost-push inflationary pressure. These pressures have emerged mainly from constraints on supply and onerous regulations which are driving up the price of everyday essentials for consumers. Recent actions and political efforts by Congress to

[32] This data come from Personal Income and Outlays, U.S. Bureau of Economic Analysis, May 2022.

increase regulations and taxes, impose costs on businesses, and these costs are ultimately reflected in higher consumer prices. Similarly, government regulations and restriction on domestic energy supplies lead to shortages that drive up domestic energy prices.

Second, the administration must accept that government stimulus has created demand-pull tensions, where excessive spending creates demand in excess of supply. While this may have been necessary early during the COVID crisis, its continuation and magnitude fueled price hikes, and adding further stimulus in the future will only do the same. Congress and administration need to refrain from additional spending programs.

It's time for some self-control by policymakers and to avoid future policies that will only hurt the very consumers these actions are meant to help.