

# Testimony of Dr. Tyler Goodspeed before the U.S. House of Representatives Subcommittee on Economic and Consumer Policy

**To:** Members of the Committee on Oversight and Reform – Subcommittee on Economic and Consumer Policy  
**From:** Dr. Tyler Goodspeed  
**Date:** September 22<sup>nd</sup>, 2022  
**Subject:** Subcommittee Hearing entitled, “Power and Profiteering: How Certain Industries Hiked Prices, Fleeced Consumers, and Drove Inflation”<sup>1</sup>

Chairman Krishnamoorthi, Ranking Member Cloud, and Members of the Subcommittee:

Thank you for the opportunity to testify before you today on an issue of utmost concern for the U.S. economy and American households, namely, the substantial rise in inflation in the United States over the past 18 months.

I am a Kleinheinz Fellow at the Hoover Institution at Stanford University and the U.S. Director at Greenmantle LLC, a global macroeconomic advisory firm. From 2017 to 2021, I had the privilege to serve on the President’s Council of Economic Advisers as Senior Economist, Chief Economist for Macroeconomic Policy, Member, Vice Chairman, and Acting Chairman. In the latter roles I advised on the economic policy response of the Federal government to the worst macroeconomic shock to hit the U.S. economy since the Great Depression, a response which contributed to the 2020 recession being officially the shortest recession in U.S. history. In my academic work I have published extensively on economic and financial history, monetary economics, and the role of access to credit in mitigating adverse macroeconomic shocks.

In 2021 and 2022, the U.S. economy has experienced the highest level of consumer price inflation since 1981, with the Consumer Price Index (CPI) rising 9.1% in the 12 months through June 2022, and remaining above 8% in the six months through August. If home prices factored directly into the calculation of the CPI, as they did before 1983, measured inflation would likely have been even higher, as the median home sale price has risen by more than 20% since the end of 2020. Whereas in early 2021 higher inflation was confined to a relatively narrow set of price categories, it is now broad-based. Various measures of underlying inflation indicate that the less volatile, more inertial components of the price level are now rising at an annualized rate of 7 to 9%.<sup>2</sup>

Fundamentally, this four-decade high in inflation is the consequence of demand substantially outstripping supply in the U.S. economy. To a partial extent this has been a global phenomenon, as global supply continued to sustain disruptions due to the COVID-19 pandemic. However, factors that are global in nature—supply chain issues, pandemic-related labor market disruptions, or corporate profit-seeking—cannot explain the initial surge in inflation in the United States and consequent rise in inflation expectations, because the magnitude of the increase in the rate of inflation in 2021 was so much greater in the United States than that observed in other advanced and major economies, and

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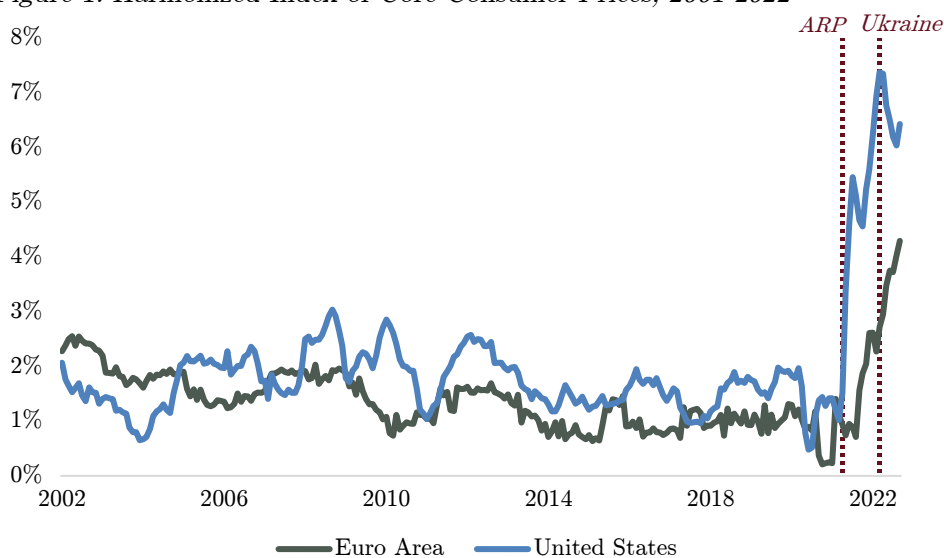
<sup>1</sup> I previously presented parts of this testimony to the U.S. House of Representatives Committee on Financial Services on 8<sup>th</sup> March 2022. I have updated the reported data to reflect new data available since that time. See T. Goodspeed, “Testimony of Dr. Tyler Goodspeed before the U.S. House of Representatives Committee on Financial Services,” (08 March 2022).

<sup>2</sup> These measures include the Federal Reserve Bank of Cleveland’s Weighted-Median CPI and Trimmed-Mean CPI, the Federal Reserve Bank of Atlanta’s Sticky CPI, and the Bureau of Labor Statistic’s core CPI (CPI excluding volatile food and energy). The average of the four measures in August was 7.9% at a seasonally adjusted annual rate.

coincided precisely with an unprecedented demand shock in March 2021. As shown in *Figure 1*, comparable measures of core consumer price inflation in the United States and the Euro area, which previously tracked each other closely, diverged sharply in 2021, with the break occurring in March 2021.

Compared to 45 other major economies tracked by the Organisation for Economic Co-operation and Development (OECD), the increase in the average level of inflation in the United States in 2021, relative to its 2019 pre-pandemic average, was greater than in all 45 other economies except Saudi Arabia, Brazil, and Turkey (*Figure 2*). Explanations of high U.S. inflation that are global in nature—for example, supply chain disruptions or increased market concentration—are therefore unlikely to explain all of the increase in inflation in the United States, most of which preceded the February 2022 invasion of Ukraine by the Russian Federation. Instead, a key difference between the United States and other major economies is that U.S. fiscal policy in 2021 stimulated demand on an unprecedented scale while simultaneously impeding a recovery in supply.

*Figure 1. Harmonized Index of Core Consumer Prices, 2001-2022*



*Note:* Year-over-year percent change. HICP excluding food and energy for the United States. HICP excluding food, energy, alcohol and tobacco for Euro area. HICP for the total U.S. population (HICP-T) is not available before December 2002 or after April 2022, so I extend the series by multiplying the available HICP for all urban consumers (HICP-U) by the average ratio of HICP-T to HICP-U in the most proximate 12-month period.

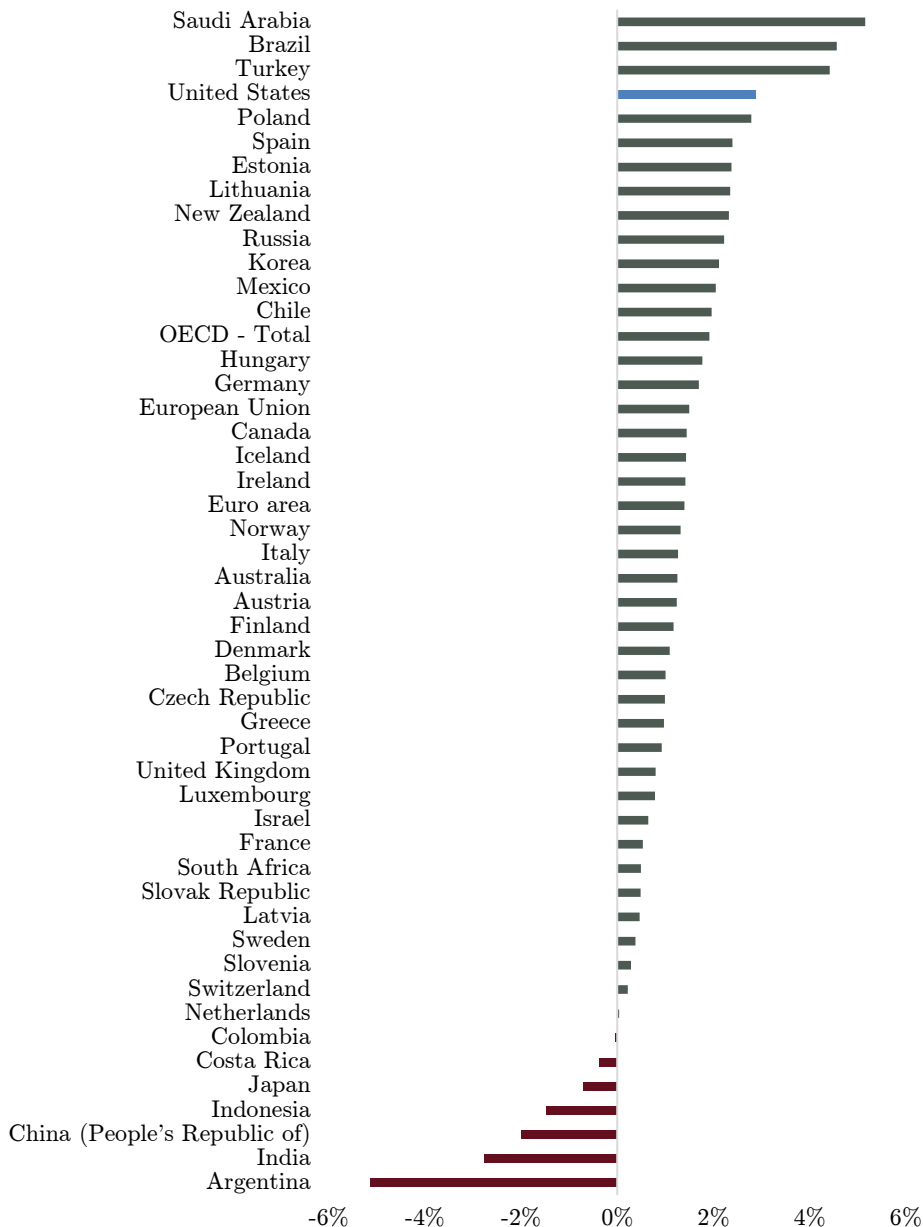
*Source:* Eurostat via Federal Reserve Bank of St. Louis; Bureau of Labor Statistics via Haver Analytics; author's calculations.

Specifically, in March 2021, Congress passed and President Biden signed into law the American Rescue Plan Act of 2021, which introduced stimulus spending equal to approximately 9% of the annual output of the entire U.S. economy, while increases in implicit marginal tax rates on employment impeded a recovery in labor force participation, and uncertainty surrounding the future path of domestic business taxation likely raised the option value of deferring new business investment. I address both the demand- and supply-side impacts in turn.

A fiscal stimulus during an economic expansion of the magnitude of the \$1.9 trillion American Rescue Plan Act was unprecedented in postwar U.S. history before 2021, and immediately followed \$900 billion in additional pandemic-related spending already introduced under the Consolidated Appropriations Act, 2021. Applying conventional fiscal multipliers to a deficit-financed fiscal expansion of this size would imply aggregate demand rising to level as much as 5 to 6% above pre-pandemic forecasts of potential output.

Though an excess of aggregate demand over potential output of this magnitude would on its own generate substantial upward pressure on the price level, it understates the extent of the supply-demand imbalance introduced by the American Rescue Plan, because actual potential output in the supply-constrained context of the ongoing pandemic in 2021 was likely lower than pre-pandemic estimates of potential. In addition, it does not account for any drawdown of above-trend savings accumulated by households under the CARES Act and Consolidated Appropriations Act, 2021, which already totaled \$1.5 trillion at the end of 2020. Any residual between nominal aggregate demand and potential output would then translate directly into higher prices.

*Figure 2. Change in Annual Average Consumer Price Inflation, 2021 versus 2019*



Source: OECD; author's calculations.

The impact of an excess demand shock arriving in March 2021 is observable in the timing of the divergence between U.S. and Euro area core inflation, as measured by the Harmonized Index of

Consumer Prices (HICP).<sup>3</sup> Whereas in the 12 months through February 2021, core HICP rose at roughly the same pace in the Euro area as in the United States (1.1% versus 1.0%, respectively), from February 2021 through February 2022 the increase in the core HICP inflation rate in the United States was quadruple that in the Euro area. Though HICP data for the total U.S. population (HICP-T) is not yet available for the United States since April 2022, if we estimate it using observed HICP for all urban consumers (HICP-U) and the average ratio of HICP-T to HICP-U in the preceding 12-month period, the increase in the rate of core inflation in the United States from February 2021 through August 2022 was still almost double that in the Euro area, despite the latter being more directly impacted by the Russian Federation’s invasion of Ukraine. Indeed, since the Russian Federation’s invasion of Ukraine, there has been convergence in inflation rates between the United States and the Euro area, which indicates that the surge in inflation in the United States preceded rather than succeeded that adverse shock.

In the context of an ongoing pandemic and the associated impediments to the consumption of services, the American Rescue Plan generated a surge in demand for goods, with personal consumption expenditures on goods rising by 10.7% in the month of March 2021 alone (240% at an annualized rate). Soaring demand for goods placed severe strain on the capacity of U.S. ports to process increased import volumes. Despite port congestion being cited as a major contributor to rising inflation, U.S. ports actually handled record import volumes in 2021—approximately 20% above 2019 volumes. When we observe both price and quantity rising, economists associate that with demand increasing by more than supply. If port congestion in 2021 had instead been caused by a disruption to port capacity rather than an increase in demand, we would have observed rising prices but falling quantities. Port congestion in 2021 is therefore more likely a symptom of an over-stimulated economy, rather than a cause of it.

However, the American Rescue Plan did also adversely impact the recovery of the supply-side potential of the U.S. economy, in particular the recovery in labor force participation. The extension of a \$300-per week Federal supplement to unemployment insurance benefits until September 2021 effectively raised the implicit marginal tax rate on the return to work, while an expansion of the Child Tax Credit (CTC) through the end of 2021 also raised implicit marginal tax rates on workers. Not only did a larger credit raise implicit marginal tax rates over the income phase-out thresholds, but also a lower phase-out threshold for the increased credit meant that more workers were affected by those higher implicit tax rates. Moreover, as Corinth et al. (2021) demonstrate, the expanded CTC under the American Rescue Plan also increased implicit marginal tax rates on the return to work over the phase-in threshold by substantially lowering the return to work relative to the expansion of the CTC under the 2017 Tax Cuts and Jobs Act.<sup>4</sup> The labor force participation rate rose just 0.4 percentage point from March to December 2021, and ended the year only 0.2 percentage point above its August 2020 level. At the end of 2021, labor force participation was still 1.5 percentage points below its pre-pandemic level, implying 3.9 million missing workers.

While the preceding analysis has focused on macroeconomic aggregates, it is important to not lose sight of the effect of the inflation shock of the past year on American workers and households. While average wages increased in nominal terms in 2021, they decreased in inflation-adjusted terms, as nominal wage growth was unable to keep pace with rising inflation. Even fixing the composition of the workforce, which can change over the course of a recovery, employee compensation has declined in inflation-adjusted terms by 4.5% since the fourth quarter of 2020, and is now 6.3% below pre-pandemic trend.

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<sup>3</sup> Core HICP (excluding volatile food and energy) for the United States is available from the Bureau of Labor Statistics via Haver Analytics. Core HICP for the Euro Area is available from Eurostat via the Federal Reserve Bank of St. Louis, but excludes food, energy, alcohol, and tobacco.

<sup>4</sup> Kevin Corinth, Bruce Meyer, Matthew Stadnicki, and Derek Wu, “The Anti-Poverty, Targeting, and Labor Supply Effects of the Proposed Child Tax Credit Expansion,” National Bureau of Economic Research Working Paper No. 29366 (October 2021).

We observed a similar dynamic in the period of high inflation in the 1970s, when wages similarly struggled to keep pace with rapidly rising inflation. During the economic recovery from 1975 to 1980, real wages declined at an average annual rate of 1 percent. Though higher inflation erodes the value of existing debt, which can in the short-term benefit lower-income households—who tend to be more highly leveraged—borrowing costs quickly respond to account for higher expected inflation. Moreover, lower- and middle-income workers not only tend to have less bargaining power in wage negotiations, they also are disproportionately impacted by the rising cost of basic necessities—such as food, gas and rent—which constitute a bigger share of their disposable personal income. Lower-income households are also at greater risk in an inflationary environment because they have fewer financial hedges against inflation, most notably owner-occupied real estate. In the closing years of the of the Great Inflation of the 1960s to the early 1980s, rent inflation of nearly 10% was outstripping nominal wage gains.

Over the past 18 months, inflation in the United States has risen to levels not observed since the end of the Great Inflation. While inflation has risen globally, global factors cannot explain all or most of the increase in core inflation in the United States because the magnitude of that increase has been substantially greater in the United States than in other advanced economies, and the timing of the initial divergence points to domestic policy actions. A key factor in higher inflation in the United States was that fiscal policy measures stimulated aggregate demand to an historically unprecedented degree, while simultaneously exacerbating existing challenges to a recovery in the supply-side potential of the U.S. economy. The consequence was that inflation expectations had already come unanchored by the end of 2021.