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United States House of Representatives
Committee on Financial Services
2129 Rayburn House Office Building
Washington, D.C. 20515

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RANKING MEMBER

March 3, 2022

Memorandum

To: Members, Committee on Financial Services
From: FSC Majority Staff
Subject: March 8, 2022, Full Committee Hearing entitled, "The Inflation Equation: Corporate Profiteering, Supply Chain Bottlenecks, and COVID-19"

The full Committee on March 8 will hold a hybrid hearing entitled, "The Inflation Equation: Corporate Profiteering, Supply Chain Bottlenecks, and COVID-19," on Tuesday, March 8 at 10:00 am in room 2128 of the Rayburn House Office Building and on the virtual platform Cisco Webex. There will be one panel with the following witnesses:

- **Demond Drummer**, Managing Director Equitable Economy, PolicyLink
- **Rakeen Mabud**, Chief Economist and Managing Director of Policy, Groundwork Collaborative
- **Sandeep Vaheesan**, Legal Director, Open Markets Institute
- **Mark Zandi**, Chief Economist, Moody's Analytics
- **Tyler Goodspeed,** Kleinheinz Fellow, Hoover Institution

The COVID-19 Pandemic and Recent Inflation Trends

The Federal Reserve (Fed) has a mandate to pursue maximum employment and stable prices.[1] Since 2012, the Fed has targeted a long run average of two percent inflation. Policymakers at the Fed believe this target is consistent with fulfillment of its mandate, and view a low but stable level of inflation as helpful in preventing deflation.[2] As economic recovery from the recession caused by the COVID-19 pandemic continued throughout 2021, large price increases were seen in several segments of the economy. The Consumer Price Index (CPI), a metric of the cost of goods and services developed by the Department of Labor, increased by 7.5% in 2021, the highest level since 1982.[3] Officials at the Fed and central banks around the world have observed this trend, largely attributing higher prices to supply chain bottlenecks, shortages, and disruptions from the pandemic.[4] The Fed does not primarily use CPI to gauge inflation; instead it tends to focus on a measure of inflation called the personal consumption expenditures (PCE) index, which covers a broad and more dynamic range of goods.[5] Core PCE, which excludes food and energy given their volatility,[6] increased by 5.2% in 2021 and more than 3% above the Federal Reserve's long-term target, and it rose to its highest rate since 1983.[7]

In general, economists expected some inflation to occur as businesses re-opened and the economic recovery began to take off. However, inflation has been more pronounced and has manifested itself differently than many experts predicted. For example, as the leisure and hospitality sectors re-opened and people began traveling again, it was expected that there would be a surge in items like airline ticket prices,

[1] See Fed, *Section 2A, Federal Reserve Act* (Accessed Mar. 3, 2022).
[2] Federal Reserve Bank of Cleveland, *Why does the Fed care about inflation?* (Accessed Mar. 2, 2022).
[3] Wall Street Journal, *U.S. Inflation Rate Accelerates to a 40-year high of 7.5%,* (Feb. 10, 2022).
[4] New York Times, *The World's Top Central Bankers See Supply Chain Problems Prolonging Inflation,* (Sept. 29, 2021).
[5] CNBC, *The Fed uses one inflation gauge as its North Star. Here's why,* (Jan. 28, 2022). Also see Noah Johnson, *A comparison of PCE and CPI: Methodological Differences in U.S. Inflation Calculation and their Implications* (Nov. 2017).
[6] BLS, *Personal Consumption Expenditures Price Index, Excluding Food and Energy* (Accessed Mar. 2, 2022).
[7] Wall Street Journal, *Fed's Preferred Inflation Measure Reaches Fastest Pace Since 1983,* (Feb. 25, 2022).

but that these price increases would be temporary and limited to certain sectors.[8] Instead, waves of new coronavirus variants kept demand restrained in some of those sectors, but caused a sustained and unexpectedly high surge in demand across a wide range of consumer goods, leading to large price spikes for many goods, especially used cars and trucks.[9] The semiconductor shortage that contributed to higher auto prices throughout 2021 was prolonged and exacerbated when the Delta variant stalled production in numerous Asian countries.[10]

The Primary Causes of Recent Inflation Trends

Supply Chain Bottlenecks and Shortages

One of the most consequential drivers of inflation during the pandemic has been supply chain bottlenecks caused by clogged shipping ports, which have been particularly acute in the ports of Los Angeles and Long Beach. In its monetary policy report (MPR), the Fed summarized the problem as follows:

> *Over the past year, global transportation and distribution networks have been overwhelmed, and manufacturers have struggled to find the materials and labor needed to meet demand for their products. Demand for goods has been notably boosted, as ongoing concerns about COVID-19 have led consumers and businesses to shift spending away from services, such as travel, in favor of goods, such as those related to increased time at home. While some distribution and production bottlenecks showed signs of improvement toward the end of last year, other bottlenecks are expected to remain for some time.*[11]

Lack of Housing Supply

One of the largest supply-demand imbalances spurring inflation is housing. According to the MPR, house price growth has reached record highs as demand for housing has surged, while housing supply has failed to keep up and housing construction has fallen behind amidst price spikes in materials such as lumber.[12] Rent and housing prices increasing by nearly 18% during the pandemic.[13] In contrast with most supply chain bottlenecks, which many experts expect to eventually dissipate as pandemic recovery continues, the impact of housing on inflation is expected to be long-lasting due to both the time it takes to develop housing and the lack of investment in housing that is affordable to low- and moderate-income families. Although the growth rate is expected to decline, economic analysts expect housing and rental costs to continue to climb this year.[14] If housing costs remain high, this will likely contribute to sustained inflationary pressure. Housing comprises about one-third of CPI and about one-fifth of the core PCE measure of inflation used by the Fed.[15]

Lack of Competition

Over the last several decades, there has been a notable increase in economic concentration across many different industries in the United States, reducing competition across a wide range of products.[16]

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[8] Amarnath and Williams, *Inflation: The Good, the Bad, and the Transitory,* (Feb. 12, 2021).
[9] BLS, *Consumer Price Index Summary* (Feb. 10, 2022); Bloomberg, *How Covid turbocharged the American consumer,* (Dec. 14, 2021).
[10] Washington Post, *Semiconductor shortage that has hobbled manufacturing worldwide is getting worse,* (Sept. 23, 2021).
[11] Federal Reserve Board of Governors, *Monetary Policy Report,* (Feb. 25, 2022).
[12] *Id.*
[13] Apartment List, *Apartment List National Rent Report* (Feb. 28, 2022); *See also* Federal Housing Finance Agency, *U.S. House Prices Rise 17.5 Percent over the Last Year; Up 3.3 Percent from the Third Quarter* (Feb. 22, 2022).
[14] New York Times, *Housing costs swell, hampering homebuyers and pushing up rents,* (Jan. 12, 2022).
[15] Wall Street Journal, *Fed's Preferred Inflation Measure Reaches Fastest Pace Since 1983,* (Feb. 25, 2022); and New York Times, *Consumer prices popped again in December, casting a shadow over the economy,* (Jan. 12, 2022).
[16] Grullon, Larkin, and Michaely, *Are US Industries Becoming More Concentrated,* (Oct. 25, 2018).

Several industries that have experienced the strongest inflationary pressures are also sectors that have become more concentrated in recent decades, including shipping containers, diapers, and rental cars.[17]

Corporate concentration across the U.S. economy has been pointed to as an explanation for numerous macroeconomic trends in the recent past, including price effects. For instance, economists have connected growing market power with a higher rate of markups, i.e., the difference between a price of a product and its cost.[18] Larger firms with greater market power have stronger pricing power. As a January *Bloomberg* article explained, "an emerging fear is that companies with market power are exacerbating inflation driven by supply-chain distortions caused by Covid-19."[19] One study suggested that lax antitrust enforcement had enhanced firms' pricing power, concluding that penalties for corporate collusion would need to be much higher to discourage price fixing.[20] Policymakers have also drawn a direct link between competitive markets and inflation. For instance, after antitrust officials blocked a merger between AT&T and T-Mobile, T-Mobile sought to compete in the cell phone market by offering lower pricing on cell phone plans, a factor that was cited by former Chair Janet Yellen in 2017 in explaining why inflation had remained below the Fed's target.[21] At his Senate confirmation hearing, Chair Pro Tempore Powell was asked if corporations in more heavily concentrated sectors are increasing their profit margins by passing on higher costs. Powell responded, "That could be right, it could also just be though the demand is incredibly strong and that, you know, they're raising prices because they can."[22]

There is also evidence that many corporations are seizing on short-term shortages, supply chain bottlenecks, and unusual pandemic conditions to pass on high prices to consumers in a variety of ways. Many restaurants, retailers, and firms like Peloton, Disney, and Harley-Davidson have imposed high fees and surcharges during the pandemic.[23] Moreover, corporate profits have generally reached very high levels over the last year, and data from the Federal Reserve indicates that this trend has been above average in sectors such as the auto industry that have been contributing heavily to the inflationary pressures.[24] Readouts from earnings calls show many corporate executives acknowledging that the costs of inflation are being passed on to consumers.[25] Earnings calls also indicate that many firms are justifying higher prices because their competitors are raising prices.[26]

Monetary Policy

The Fed uses monetary policy to control inflation. When the Fed seeks to bring inflation down, it raises interest rates, which constrains demand by raising overall borrowing costs for households, businesses, and consumers.[27] Chair Pro Tempore Powell has acknowledged the Fed's tools are only effective at stimulating or constraining demand, which will not immediately impact supply side issues and are at the root of rising prices. "[The Fed] really can't directly affect supply side conditions," Powell told the Senate Banking Committee in January 2022.[28] At a March 2 hearing, Powell further added that, "This is a lot about supply side issues, and we welcome any help we can get on that."[29]

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[17] See, e.g., Monteiro and Atkinson, *Maritime Industries- Are they becoming more concentrated?*, (2014); Bloomberg, *Diaper Inflation Wrecks Already-Strained Family Budgets in the US*, (Jul. 9, 2021); and Washington Post, *How the pandemic led to a rental-car crisis just as Americans are ready to bust loose*, (May 1, 2021).
[18] Eggertsson, Robbins, and Wold, *Kaldor and Piketty's Facts: The rise of monopoly power in the United States*, (Feb. 12, 2018).
[19] Bloomberg, *US Inflation Risks Get Sticky as Big Firms Flex Pricing Power,* (Jan. 14, 2022).
[20] Connor and Lande, *Does Crime Pay? Cartel penalties and profits*, (2019).
[21] Bloomberg, *US Inflation Risks Get Sticky as Big Firms Flex Pricing Power,* (Jan. 14, 2022).
[22] Senate Banking Committee, *Nomination of Jerome H. Powell*, (Jan. 11, 2022).
[23] Wall Street Journal, *The Hidden Ways Companies Raise Prices*, (Feb. 12, 2022).
[24] New York Times, *Democrats Blast Corporate Profits as Inflation Surges*, (Jan. 3, 2022).
[25] *Id.*
[26] New York Times, *Corporations raise prices as consumers spend with a vengeance*, (Feb. 28, 2022).
[27] Federal Reserve, *Monetary Policy: What are its goals? How does it work?*
[28] Senate Banking Committee, *Nomination of Jerome H. Powell*, (Jan. 11, 2022).
[29] House Financial Services Committee, *Monetary Policy and the State of the Economy*, (Mar. 2, 2022).

In December 2021 testimony, Powell acknowledged that inflation was more "persistent" in 2021 than many forecasters anticipated.[30] Largely in response to the inflationary trend, Chair Pro Tempore Powell announced plans to accelerate the Fed's "taper" of large-scale asset purchases (LSAPs) of Treasuries and mortgage-backed securities,[31] and the Federal Open Market Committee (FOMC) is widely expected to raise interest rates at the conclusion of its March meeting, and market participants are projecting six interest rate increases by the end of 2022.[32]

Even as Fed officials are signaling that they will soon raise interest rates in an attempt to bring down aggregate demand and reduce inflation, they continue to emphasize supply chain bottlenecks and pandemic factors as key causes of inflation. "Drivers of higher inflation have been predominantly connected to the dislocations caused by the pandemic," Powell recently noted, although he added that "price increases have now spread to a broader range of goods and services."[33] Although Powell has said that forecasters at the Fed "continue to expect inflation to decline over the course of the year,"[34] there are several risks that could continue to apply upward pressure on inflation. Most notably, Russia's invasion of Ukraine has the potential to drive up global oil and commodity prices in a sustained way, spurring higher inflation and complicating the Fed's efforts to combat inflation through tighter monetary policy.[35]

Pandemic Relief

In March 2021, President Biden signed the American Rescue Plan (ARP) into law, which included one-time stimulus payments of $1,200, billions of dollars in funding for COVID-19 vaccine distribution, over $42.5 billion to stabilize renters, homeowners, and people experiencing homelessness, and Child Tax Credit payments for one year.[36] Following the passage of the ARP, a robust economic recovery spurred strong trends in demand and consumer spending. Overall economic growth in 2021 was 5.7%, the highest level recorded since 1984.[37] Wages and salaries for workers grew by 4.5% in 2021, the highest level since 1983.[38] Researchers at the Federal Reserve Bank of San Francisco examined whether the ARP had caused the economy to "overheat" by putting too much stimulus into the economy, but found that the law had only a marginal impact on inflation, concluding that the projected impact of the ARP "translates into a core inflation rate that is about 0.3 percentage point higher per year through 2022."[39] While acknowledging that this assessment of the ARP's impact on inflation is not negligible, analysts note that this falls far short of what's typically seen as "overheating."[40] Moreover, economists have rejected the notion that ARP spending is a primary source of inflationary pressures. "Some have attributed current high inflation to greater fiscal spending in the U.S.," economists at BlackRock argued. "But this is not a classic case of overall demand in the economy – supported by fiscal policy – being unusually high. Fiscal policy cannot explain why inflation is so high when economic activity has yet to fully recover. The fundamental constraint is that supply capacity is unusually low."[41]

Congress and the Biden Administration have taken other steps to address various drivers of inflation. For example, President Biden signed two executive orders in 2021 to take a variety of administrative steps to strengthen the resilience of critical supply chains and promote competition.[42]

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[30] House Financial Services Committee, *Oversight of the Treasury and Federal Reserve's Pandemic Response*, (Dec. 1, 2021).
[31] Federal Open Market Committee, *Transcript of Chair Powell's press conference,* (Jan. 26, 2022).
[32] Politico, *The Fed is setting out to kill inflation. Brace for collateral damage*, (Feb. 16, 2022).
[33] Federal Open Market Committee, *Transcript of Chair Powell's press conference*, (Jan. 26, 2022).
[34] *Id.*
[35] Politico, *Russia oil shock looms over Fed inflation fight*, (Feb. 24, 2022).
[36] Treasury, *Fact Sheet: The American Rescue Plan Will Deliver Immediate Economic Relief to American Families*, (Mar. 18, 2021).
[37] New York Times, *U.S. Economy Grew 1.7% in 4th Quarter, Capping a Strong Year,* (Jan. 27, 2022).
[38] Politico, *The Fed is setting out to kill inflation. Brace for collateral damage*, (Feb. 16, 2022).
[39] Federal Reserve Bank of San Francisco, *Is the American Rescue Plan Taking Us Back to the 1960s?*, (Oct. 18, 2021).
[40] New York Times, *A regional Fed analysis suggests Biden stimulus is temporarily stoking inflation*, (Oct. 18, 2021).
[41] BlackRock, *A World Shaped by Supply*, (Jan. 2022).
[42] Federal Register, *Executive Order 14017* (Feb. 24, 2021), and Federal Register, *Executive Order 14036* (Jul. 9, 2021).

Congress enacted the Infrastructure Investment and Jobs Act into law in November 2021, which, among other things, will make supply chains more efficient at ports and throughout the economy.[43] The House has also passed the Build Back Better Act, which would aim to address labor and housing supply shortages through significant investments in housing and childcare, and also includes investments in supply chain resilience and other sectors.[44] Many economists,[45] including 17 Nobel laureates, have expressed their view that investments in the Build Back Better Act would help address inflation.[46]

Labor Market Conditions and Economic Growth

The pace and strength of economic growth in the United States has exceeded many developed countries, translating to an especially strong surge in demand for consumer goods.[47] In the early part of 2021, inflation was not seen as a major concern, and the economy was still 9 million jobs short of its pre-pandemic peak.[48] Economic performance has exceeded expectations and outpaced the recovery from the Great Recession, which was characterized not only by sluggish growth but by low inflation.[49] With over 6.5 million jobs added in 2021 and the economy growing at a pace where a full recovery is expected by the end of 2022,[50] the Fed is expected to end its Zero Interest Rate Policy (ZIRP) later this month as opposed to late 2023, when FOMC participants initially forecasted ZIRP would end.[51] Furthermore, this is happening at a much faster pace compared to the aftermath of the Great Recession, when the Fed raised interest rates in December 2015, more than seven years after enacting ZIRP.

According to one study, inflation disproportionately affects communities of color and households in rural areas.[52] Existing disparities in wealth and household savings have been exacerbated by the inflation of the past year, and communities of color in particular spend higher percentages of their income on food and other goods that have seen sharp price increases over the last year. Many of these same communities saw significant wage growth in 2021 as well, however. Wage growth was particularly high for low-income workers, reaching 9% last year.[53] In March, Chair Pro Tempore Powell acknowledged "wages at the bottom, in the bottom quartile, have gone up in real terms."[54] This follows several decades when wages trailed productivity growth.[55] Powell has said the Fed is monitoring wage growth to determine whether it could have an impact on inflation, stating, "Wages have also risen briskly, and we are attentive to the risks that persistent real wage growth in excess of productivity [growth] could put upward pressure on inflation."[56] So-called "wage-price spirals" have been a characteristic of persistent inflation in the past, most notably in the 1970s.[57] However, among numerous differences between the economy of today compared with that period, lower rates of unionization make a wage-price spiral less likely to occur.[58]

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[43] White House, *Fact Sheet: The Bipartisan Infrastructure Deal* (Nov. 6, 2021)
[44] The White House, *Build Back Better Framework, (Oct. 28, 2021).*
[45] Axios, *Economist group touts Build Back Better as inflation offset,* (Dec. 10, 2021).
[46] EPI, *Open letter from Nobel Laureates in support of economic recovery agenda* (Accessed Mar. 3, 2022).
[47] Milessi-Feretti, *A most unusual recovery,* (Dec. 8, 2021).
[48] Zandi, *This week in pandemic recovery,* (Feb. 22, 2022).
[49] *Id.*
[50] *Id.*
[51] *See* Federal Open Market Committee, *Summary of Economic Projections,* (Jun. 16, 2021).
[52] Business Insider, *People of Color and Rural Households are getting hit the hardest by the hot inflation of 2021,* (Nov. 24, 2021).
[53] Federal Reserve Board of Governors, *Monetary Policy Report,* (Feb. 25, 2022).
[54] House Financial Services Committee, *Monetary Policy and the State of the Economy,* (Mar. 2, 2022).
[55] Politico, *The Fed is setting out to kill inflation. Brace for collateral damage,* (Feb. 16, 2022).
[56] Federal Open Market Committee, *Transcript of Chair Powell's press conference,* (Jan. 26, 2022).
[57] Peneva and Rudd, *The Pass-through of labor costs to inflation,* (2015).
[58] Wall Street Journal, *Echoes of the Wage-Price Spiral of the 1970s,* (Feb. 11, 2022).