

# Inequality and inflation

ASSA Meetings

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# Outline

1. Understanding the underlying drivers—the disturbances to the economy—which are causing increased inflation *and* worsening inequality
2. Right question: how do we respond to these disturbances *and* their consequences?
3. Focus on monetary policy wrong: it will worsen inequality and do little to tame inflation, unless push to unacceptable levels, with long run consequences
4. Host of better ways that (i) do a better job at taming inflation; (ii) reduce inequality; and, (iii) regardless of model of inflation, have positive effect on economy

# Underlying drivers

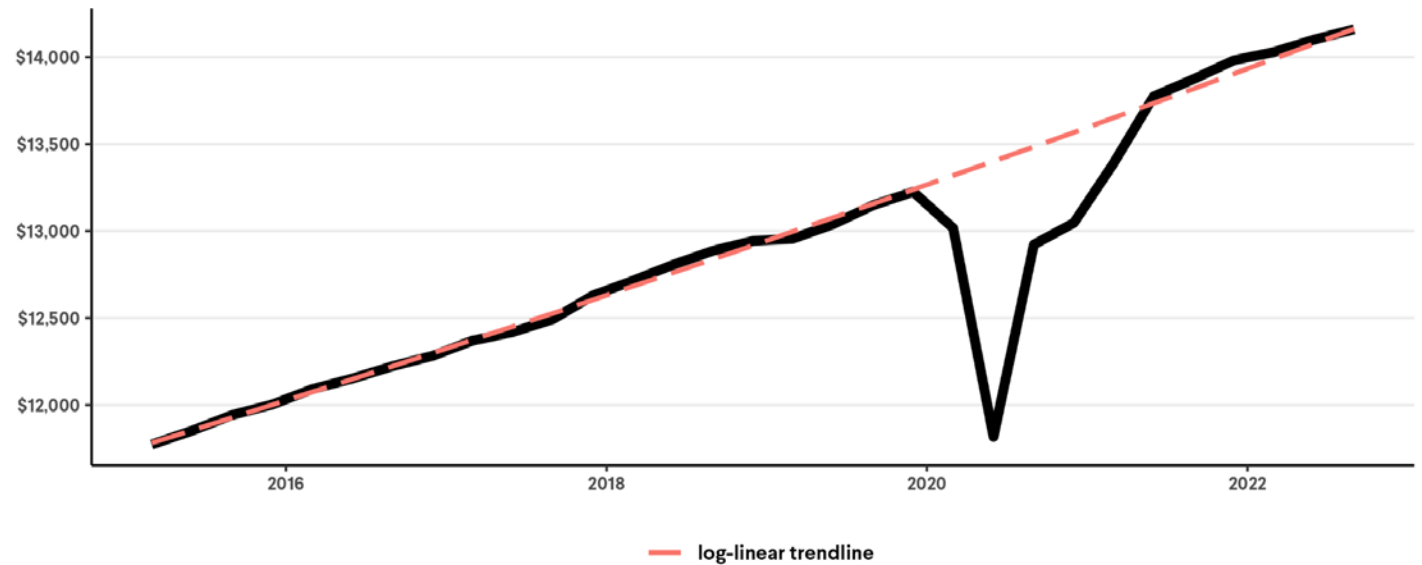
- Not excess demand
- Excess savings not caused by excess pandemic spending
- Excess savings not being spent down quickly

Excess  
consumption  
was not the  
problem

Figure 1.1

### Consumption Remained Largely below and Only Slightly above Trend

Real personal consumption expenditures (billions of chained 2012 dollars)



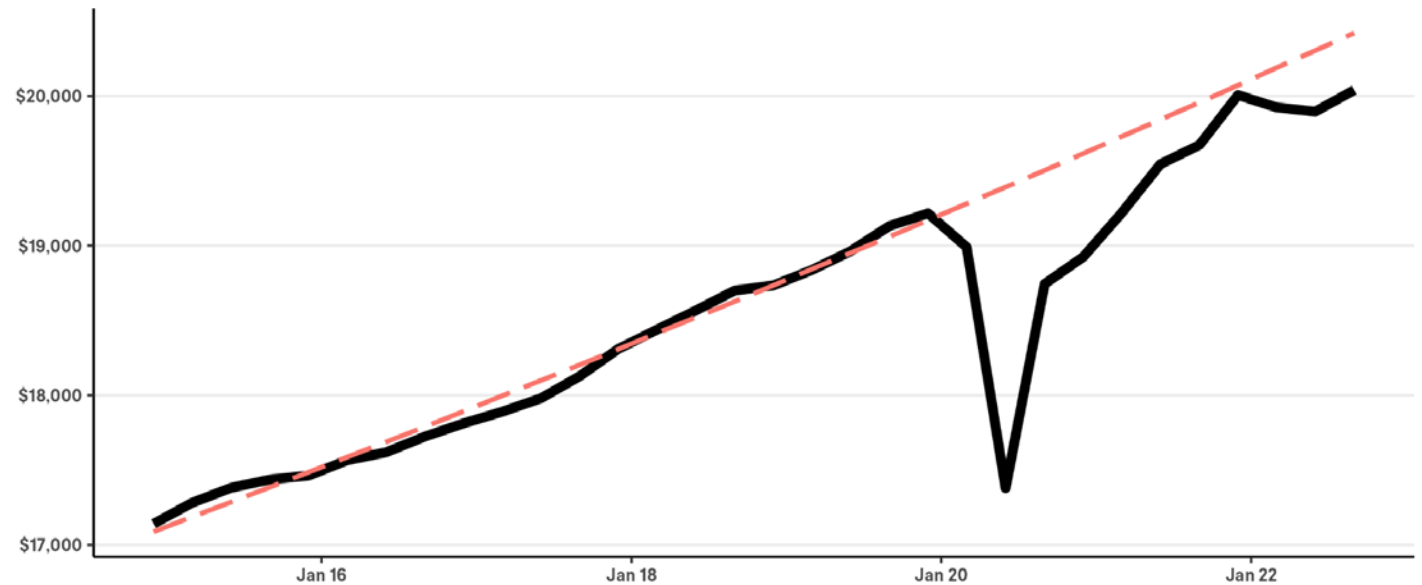
Source: NIPA Table T10106, Bureau of Economic Analysis. Authors' Analysis.

Total Real  
Aggregate  
demand  
below trend

Figure 1.9

### Real GDP Is Still below Trend

(Billions of chained 2012 dollars)

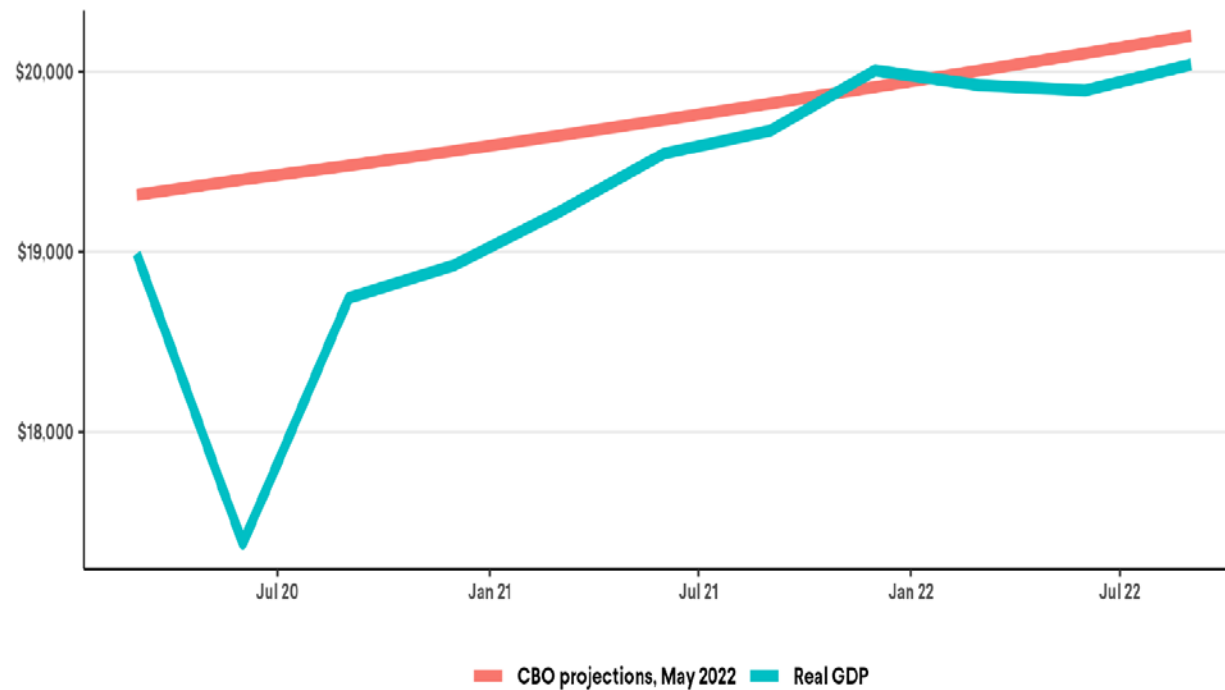


Source: NIPA Table T10106, Bureau of Economic Analysis. Authors' Analysis.

# Real Aggregate Demand below CBO estimate of potential output

## Actual GDP Is Mostly below Recent Potential Estimate

(Billions of chained 2012 dollars)

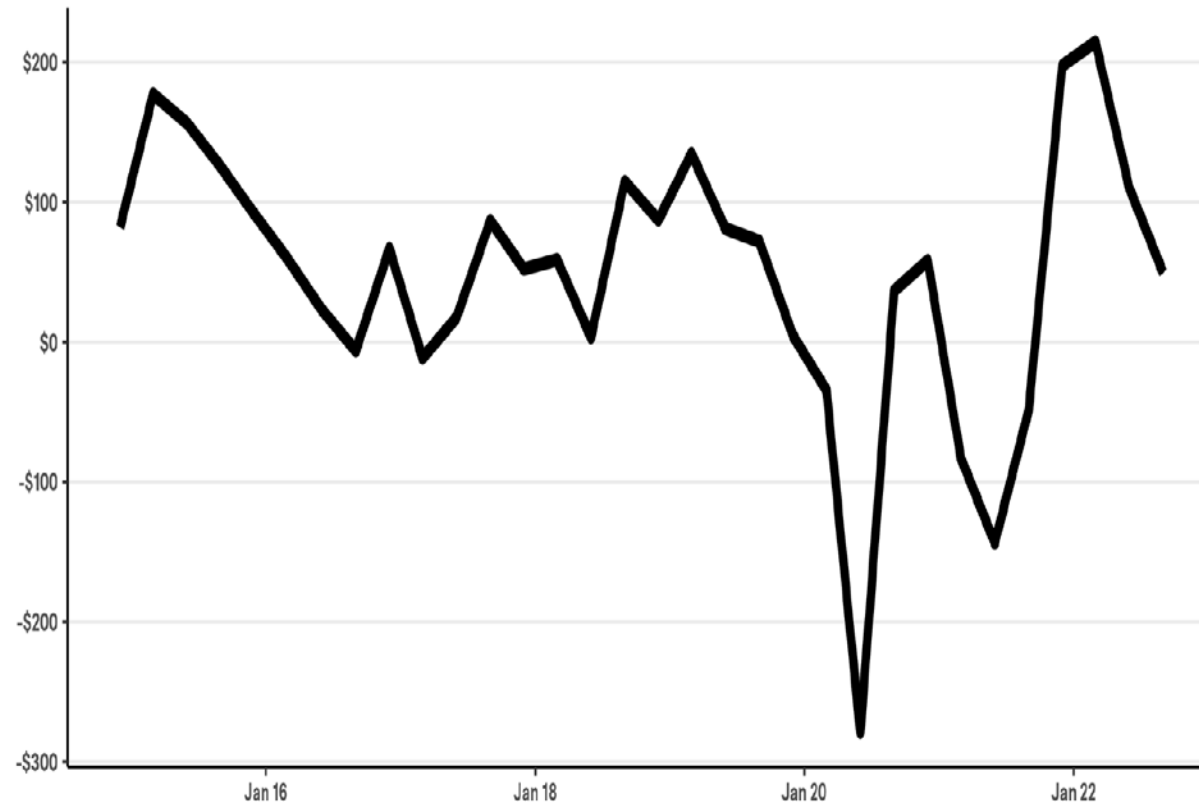


Source: NIPA Table T10106, Bureau of Economic Analysis and CBO.

# Large inventory accumulation sign of weak aggregate demand

## Inventory Accumulation Shot Up in 2021

Change in private inventories (billions of chained 2012 dollars)

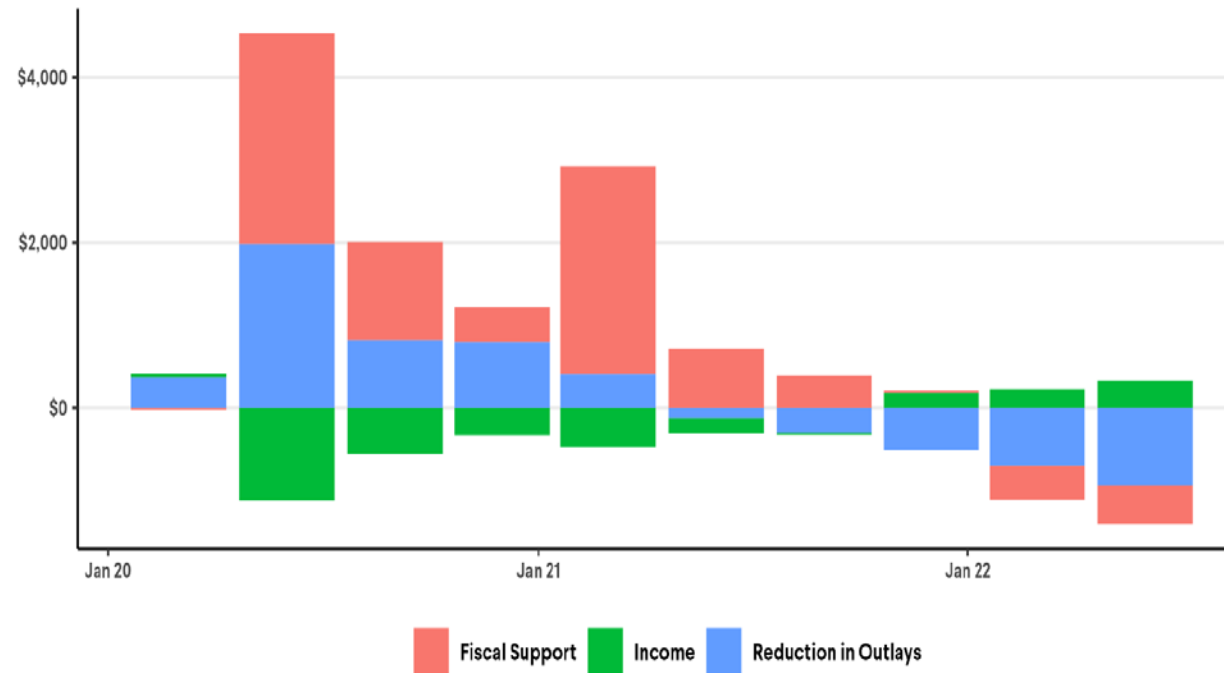


Source: NIPA Table T10106, Bureau of Economic Analysis.

# High fiscal spending only part of cause of excess savings

## Contribution to Excess Savings

(Billions of dollars, annual rate)



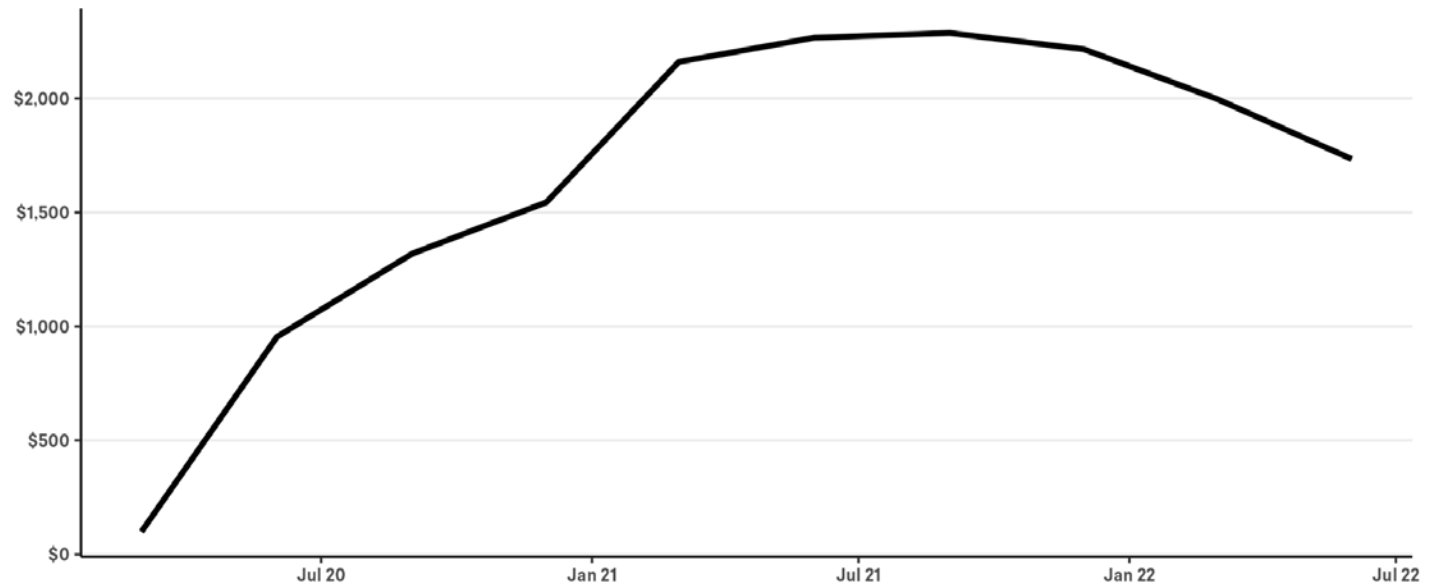
Source: Excess Savings during the COVID-19 Pandemic, Federal Reserve (Aladangady et al. 2022).



Excess savings  
has only been  
spent down  
slowly

### Stock of Excess Savings

(Billions of dollars, annual rate)

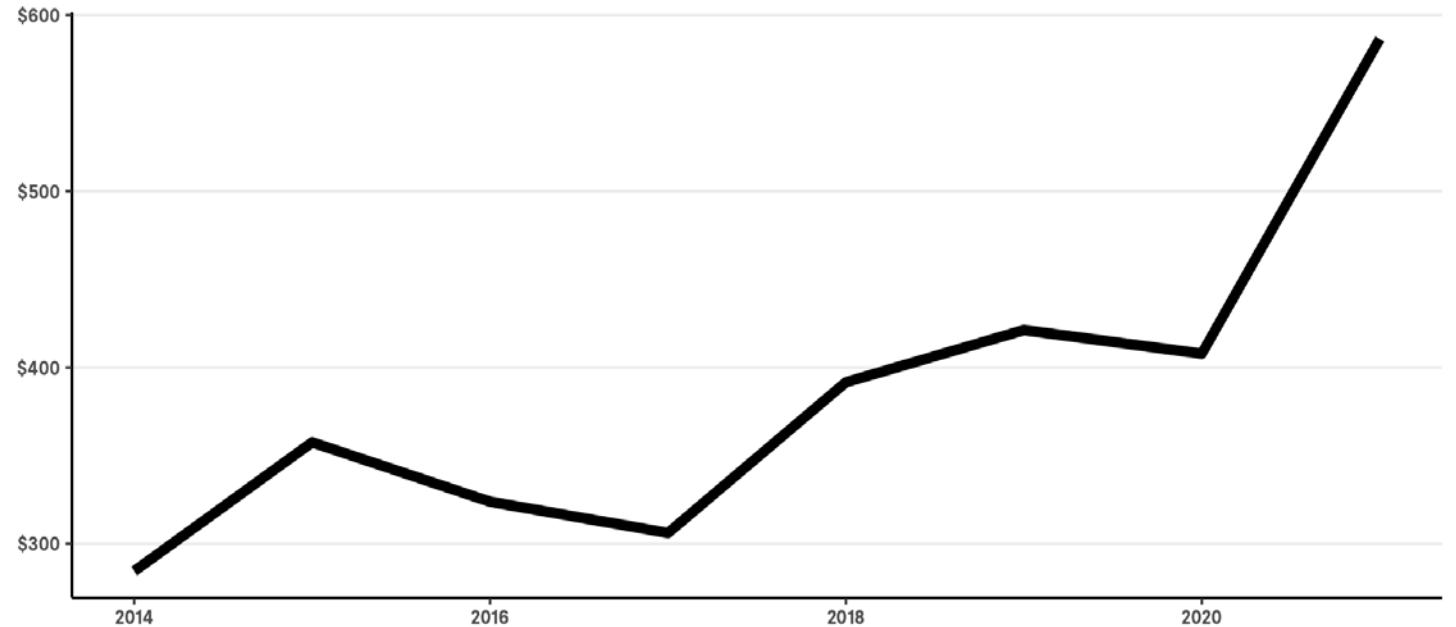


Source: Excess Savings during the COVID-19 Pandemic, Federal Reserve (Aladangady et al. 2022).

Much of spending  
down of excess  
savings went for  
taxes not withheld

### Payment of Non-Withheld Taxes Surged in 2021

(Billions of dollars)

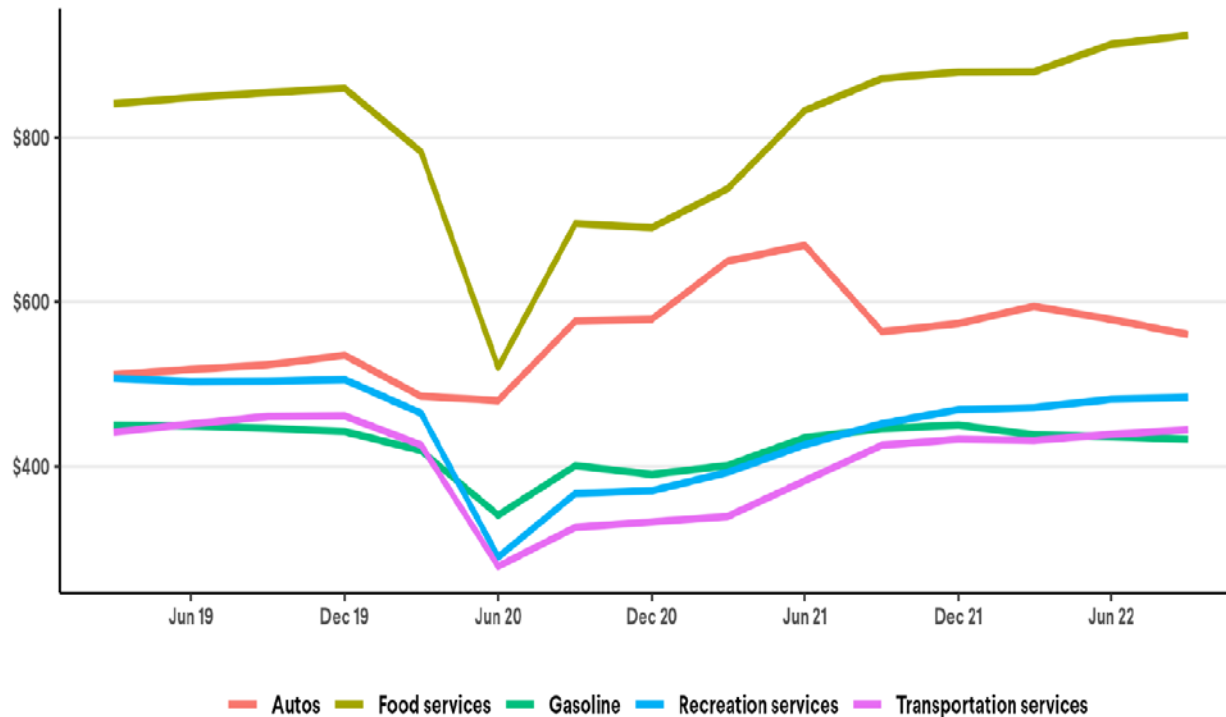


Source: NIPA Table 3.4, Bureau of Economic Analysis. Authors' Analysis.

# Even consumption of non-traded goods (sector most likely affected by excessive pandemic spending) did not surge

## Consumption Expenditures on Some Major Product Types

(Billions of chained 2012 dollars)

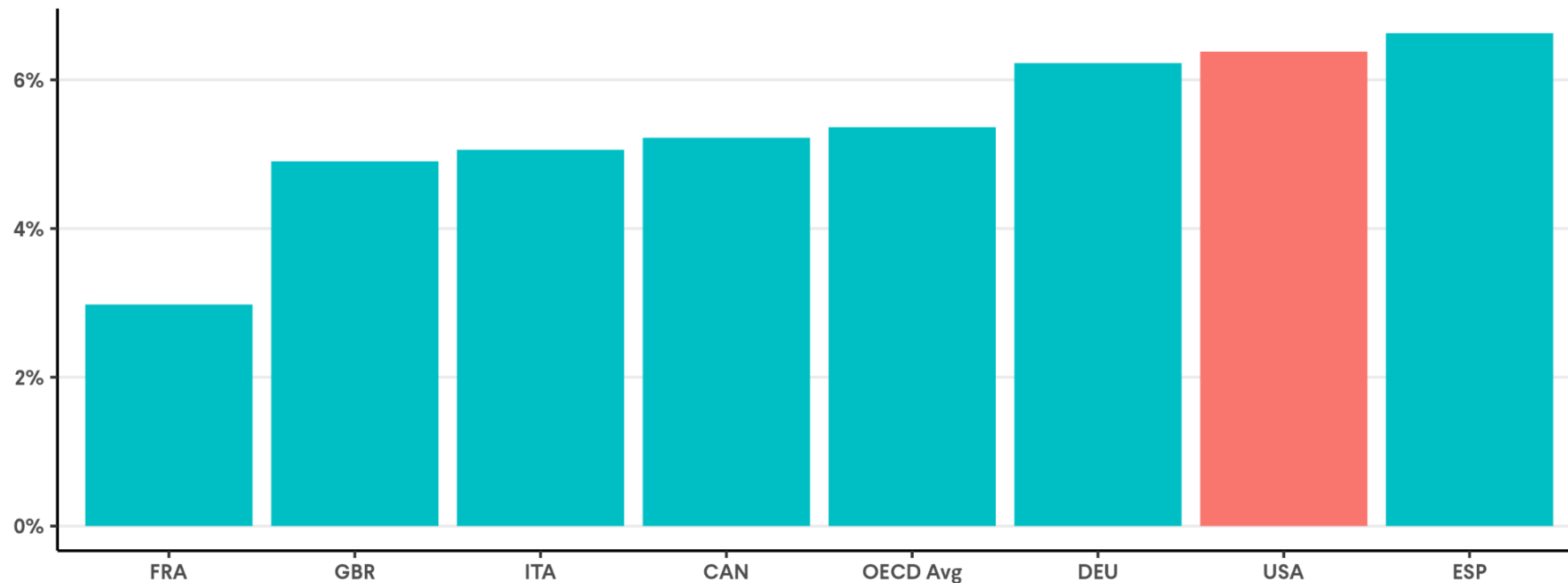


Source: NIPA Table T20306, Bureau of Economic Analysis.

# Increase in US inflation only slightly higher than other advanced countries

## Increase in Total Inflation (Pre- And Post- Pandemic)

OECD data on annual growth rate of consumer price index



Turkey as an outlier was dropped from OECD average. Change in inflation is determined by calculating the annualized rate of change in CPI from (Dec 2020 to May 2022) and subtracting that from the annualized rate of inflation from December 2017 to December 2019.

# Multiple differences in policies

- Much higher pandemic spending
- Much worse pandemic labor policies (higher unemployment rate)
- Much worse working conditions and job protections
- Much poorer health policies

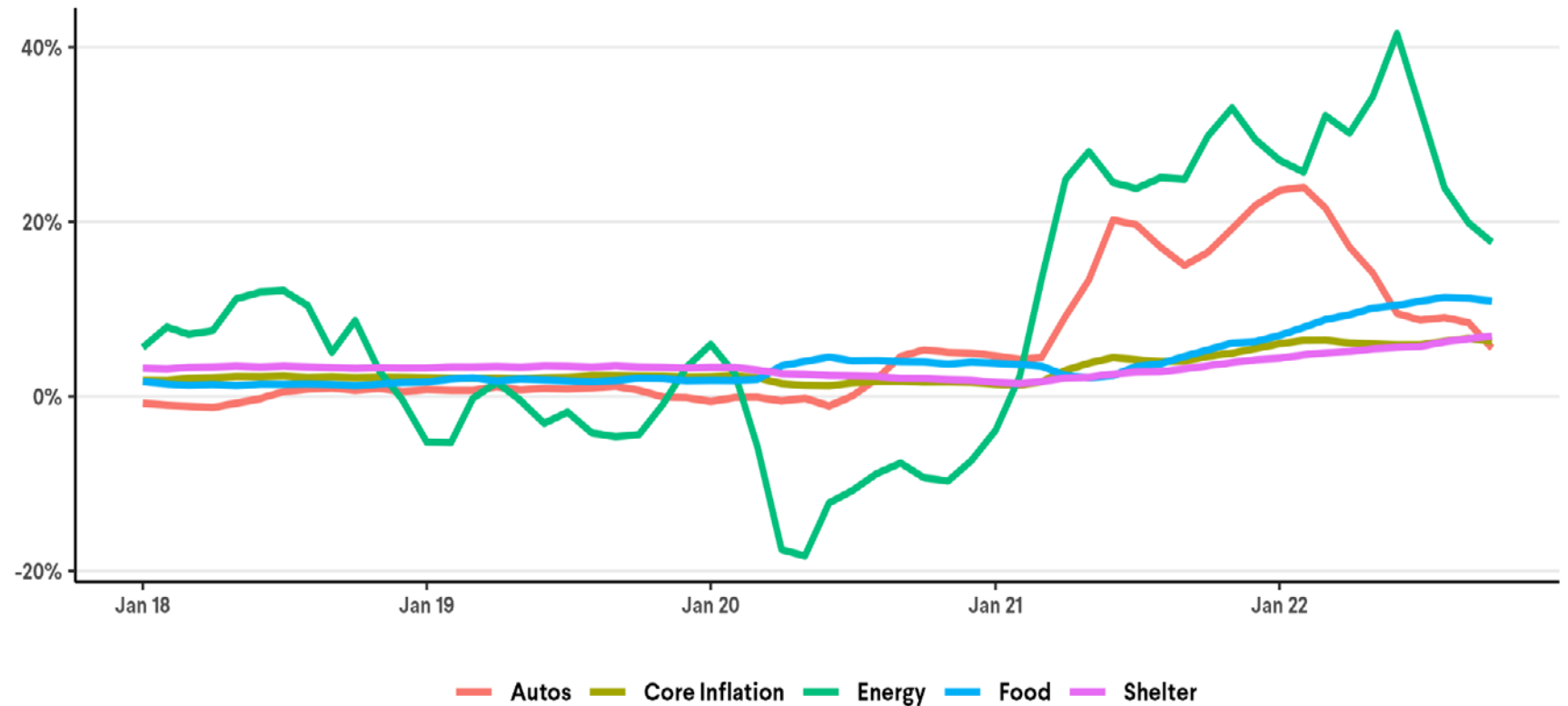
# Source of inflation

- Pandemic induced supply side shortages
- Demand shifts, partly induced by pandemic, partly induced by large changes in relative prices, partly induced by supply shortages in other sectors
- Unexpected lack of resilience—consequence of short-sightedness
  - Asymmetric price responses—with shortages leading to greater price increases than excess demands leading to price decreases
  - Exemplified by rental market
- Exercise of market power—with prices going up more in sectors and with firms with more market power
  - Phelps/Winter/Greenwald/Stiglitz model predicts greater uncertainty leading to higher mark-ups
  - Again, lack of resilience—baby formula
- All exacerbated by war

# Price increases centered on certain sectors

## Inflation Rate for Select Items, 2018-2022

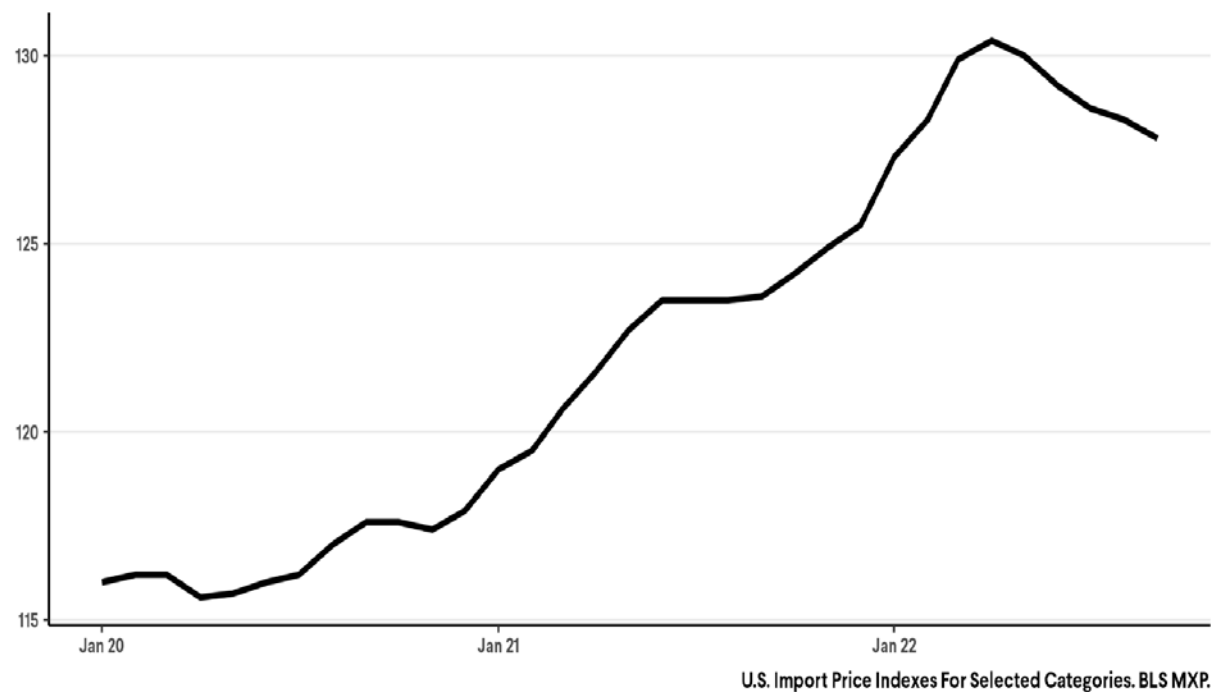
Year-over-year percent change, Consumer Price Index



Source: Bureau of Labor Statistics, Consumer Price Index. Authors' Analysis.

# Including imported goods other than fuel

Non-Fuel Import Prices

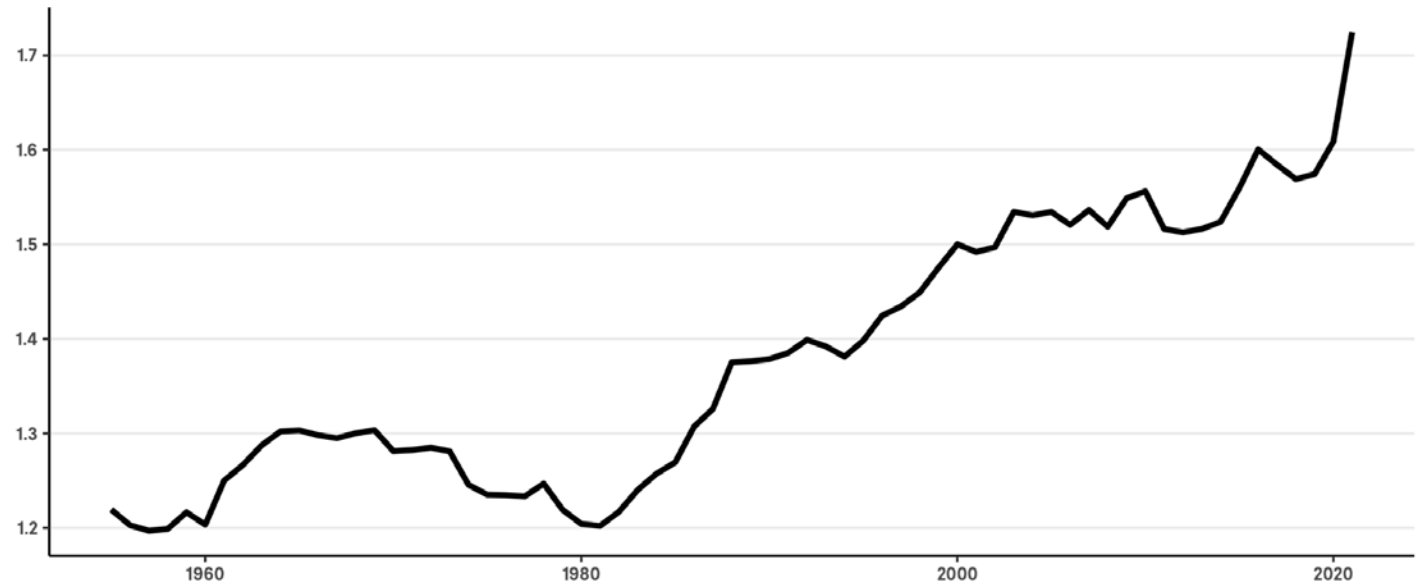




Large  
increase in  
mark-ups

### Aggregate Markups, 1955-2022

Revenues over cost of goods sold



Source: Konczal and Lusiani 2022.

Short run  
correction in  
low wages in  
some sectors

### Average Hourly Earnings, Three-Month Percent Change

Production and nonsupervisory employees, seasonally adjusted



Source: Bureau of Labor Statistics, Authors' Analysis.

# Picture today

- Inflation is being tamed, as pandemic and its effects weaken
  - Bottlenecks being resolved
  - Disinflationary forces at play (oil, cars, etc.) as sectoral prices normalize
- Inflationary expectations remain tame
- Wages not keeping up with prices—not a sign of tight labor market; in any case, no evidence of out of control wage price spiral
  - Limited bargaining power of workers
- Wages can and should increase at pace faster than is in long run sustainable
  - To increase real wages
  - Mark-ups can and should decrease
- Inflation has seeped into core, and overall disinflationary process may be slow
  - 2% target totally arbitrary
  - And cost of getting there quickly may be very high

# Why monetary policy is not the right instrument

- Problem not caused by excess of aggregate demand
- Monetary policy doesn't address underlying source of problem—won't resolve supply bottlenecks
- May make matters worse
  - Will discourage investment required to resolve them
  - In “customer markets” (Phelps/Winter/Greenwald/Stiglitz) increases in interest rates induce firms to raise prices
  - Some evidence that higher interest rates get passed on in rents

# Monetary policy increases inequality

- Increased unemployment
  - Hitting hardest at marginalized groups
  - Significant hysteresis effects
- Globally even more adverse
  - New form of “beggar thy neighbor policy”
  - Recessions in Europe, elsewhere will be worse
  - Global debt crisis
    - Increased value of dollar
    - Higher interest rates
    - Slower global growth

# There are alternative policies

- Real supply side policies
  - Increasing green energy
  - Increasing food production
  - Increasing labor supply
    - Better childcare, family leave policies
    - Increased wages
    - Immigration reform
  - Stronger and better enforced anti-trust policies
- Better protective policies, partially financed by windfall profits tax
  - Can be designed to discourage price increases
- These policies have long term benefits, even if inflation turns out to be more transitory than seems to be the case now