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Inflation: Where Did It Come From and How Can We Fix It?

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What Is Inflation

Inflation is, generally, an increase in prices throughout an economy. Typically, the government measures inflation by looking at the price of particular products every year and calculating the increase of each. So if a gallon of gasoline cost about $2.50 in January 2021 and about $3.50 in January 2022, gasoline prices increased 40%. This increase is then averaged together with the increases/decreases in other prices to find an economy-wide inflation rate. The government tries to select a representative sample of products based on what the typical consumer purchases in order to get a sense of how inflation affects most people's daily lives.

What Causes Inflation

For more than a century, economists have understood inflation to be the result of "too many dollars chasing too few products." In other words, it results when an employer pays workers more than their labor is "worth" (as defined by the amount of products/services they produce). Similarly, inflation also results from too much government spending, because it puts money in workers' pockets without producing anything. In both of these situations, workers have more money than things to buy, so companies can raise prices and people will still purchase their products.

Since the late 1970s, policymakers have intervened in expanding economies and periods of low unemployment in order to "keep inflation low." This rhetoric also allowed policymakers to cut labor protections and safety net programs such as unemployment insurance and food stamps, as these benefits pushed more money into consumers' hands. **However, fighting inflation by lowering government spending and engineering higher unemployment rates is not only a pessimistic view of the economy—it is also analytically incorrect.**

This explainer illustrates why the current period of high inflation is not simply a story of dollars and products. There are other forces at work, and they have been compounding for decades, driven by the greed of the already wealthy. The COVID-19 pandemic disrupted a fragile balance, and inflation was the inevitable result. **But corporate executives also took advantage of the disruption to raise prices for**

their own gain ("profiteering"). To make prices affordable again, policy must address both causes, and not treat this crisis as a momentary problem.

How the Pandemic Inflated Prices

Our current inflationary spiral began when the COVID-19 pandemic caused snags in the supply chain. In February 2020, grocery stores stocked exactly as much product as was being purchased on an average week. Then in March, when thousands of people suddenly all wanted products such as hand sanitizer and toilet paper, stores ran out of these products. The shortage led to pressure on factories to increase production and on truckers to get products from the factories to the stores. Our supply chains were unprepared for this rapid change.

The pandemic disrupted supply chains in two major ways. Consumers stayed home in order to avoid the virus, shifting their purchasing from services to products. For example, many people stopped eating at restaurants and started purchasing food at grocery stores. Simultaneously, workers in manufacturing and supply chain-related industries also stayed home. This (often) self-imposed isolation was a crucial public health decision: factories, processing plants, and warehouses are often overcrowded, and many early COVID-19 outbreaks occurred in these workplaces.

The increase in demand for products, coupled with lower capacity for production and distribution, meant there were not enough products for all the people looking to purchase them. Shortages were rampant, and supply chains were overwhelmed as businesses tried to correct problems hastily. For example, seeing heightened consumer demand for masks, drugstores over-ordered masks from distributors. Distributors, seeing heightened drugstore demand, over-ordered masks—above the over-ordering from drugstores—from manufacturers. Each link in the supply chain worsened the effect because no company wanted to run out of product. As a result, the businesses that provided the raw materials ended up completely overwhelmed.

Importantly, the volume of increased products not only overwhelmed producers, but also overwhelmed the physical infrastructure. The ports of Los Angeles and Long Beach were so overrun by container ships in mid-2021 that the ships spent an average of 18 days just waiting to be unloaded. And after unloading, containers frequently waited at docks for more than five days due to a nationwide trucker shortage. In other words, there was no way to process the products to even distribute them to their point of sale. (These pileups have continued into 2022, highlighting the long-term disinvestment in our nation's rail, trucking, and warehouse sectors.)

To an extent supply chain difficulties should be expected during a global pandemic. But they should have been less severe and much shorter. Why weren't they? Corporate greed.

Greed Produces Fragility: Why the Supply Chain Collapsed

Efficiency Maximization Reduces Supply Chain Capacity

For the past several decades, corporations have been reducing capacity in favor of "efficiency." **Instead of maintaining equipment and inventory on the off-chance they will be needed, corporations have eliminated them entirely.** For example, when a hospital has 200 beds and they only use 50 of them on a daily basis, why not get rid of those "extra" 150? This is particularly true when hospital executives know they must pay nurses and janitors to keep those extra 150 beds patient-ready, changing the sheets and sanitizing the furniture. It's a lot of work, and hospitals can keep costs down by just eliminating those beds.

This principle was copied in nearly every sector of the economy. In product-based sectors, the trend even has a name: "just-in-time" logistics. Instead of having components and replacement parts in-house, companies order new ones as they need them. The idea is to save money from over-ordering and free up space that can be used for ongoing business. In practice, just-in-time logistics only minimizes costs when supply chains operate in the same way every day. When large shocks come, it leaves businesses vulnerable. All of a sudden, those "extra" hospital beds are critical for saving lives.

Overreliance on Independent Contractors Causes Worker Shortages

Cost-cutting goes beyond maximizing supply chain efficiency. Increasingly, employers are hiring independent contractors rather than employees. Independent contractors are exempt from many workplace protections that employers must provide employees. **For example, employers are not required to pay independent contractors a minimum wage, provide healthcare or other benefits, or protect independent contractors from harassment and discrimination.** This practice illustrates one way employers have decimated worker power by depressing wages and withholding benefits workers have earned.

Overreliance on independent contractors has had devastating consequences for the supply chain. Many truck drivers are independent contractors (or are misclassified as independent contractors), and a large number do not own the trucks they drive: they are forced to lease them from trucking companies. This has trapped truckers in a spiral of debt, and many have simply left the industry, leaving it shorthanded when the pandemic struck. Further, because many of those who stayed were classified as independent contractors, they did not receive healthcare from their employers. A 2014 study found that more than one-third of long-haul truckers were uninsured. In other words, during a global health crisis, our most vulnerable workers were those necessary for the supply chain to exist.

Globalization Leaves Supply Chains Vulnerable to Local Stresses

Corporations have globalized their supply chains, primarily in an attempt to decrease labor costs. **Instead of paying a minimum wage to U.S. workers, multinational**

corporations have evaded labor and workplace standards by outsourcing manufacturing jobs internationally. This has generated a global race-to-the-bottom in workplace standards as countries compete to attract corporate investment. The fewer labor regulations a country has, the cheaper it will be to manufacture products and the more a corporation will be interested in locating a factory there.

Outsourcing has created a more complex supply chain that, when combined with just-in-time manufacturing, is vulnerable to sudden local shocks. For example, the Chinese government recently locked down Shanghai to prevent COVID-19 outbreaks. This has halted production for many corporations with operations in Shanghai, exacerbating supply chain problems that had begun to ease.

Corporate Consolidation Concentrates Power Among a Few Companies

Corporations have used anti-competitive practices to hoard profits and raise prices. Under the theory of a perfectly competitive market, economists predict that prices will remain low because companies will compete to attract customers. If two businesses sell apples, but one prices apples at $1 each and the other prices apples at $1.10 each, customers will buy apples from the first company. Thus, if the second company wants to make any money, it must reduce its prices below the first company's price. In theory, this race continues until apples cost exactly the same as they do to produce. While this is not actually how prices are chosen, it provides a useful framework for understanding how corporations have slanted the playing field.

In reality, corporations can gain more control over their prices by eliminating their competitors. For decades, the number of new businesses has decreased as large corporations have absorbed or outmaneuvered smaller competitors. In some industries, such as meatpacking, shipping, rail, and baby formula, a few companies have been so successful that they have effectively become the only businesses that exist. As a result, these "monopolies" can dictate prices to both consumers and producers: shoppers have no other way to get chicken, and ranchers have no one else who will buy their chicken.

Corporate consolidation—either through mergers or through other anti-competitive practices—has contributed to the weakness of the supply chain. When one company supplies most of the baby formula in grocery stores and its supply chain collapses, it leads to nationwide formula shortages. With a large number of suppliers, there are multiple supply chains, and if any one of them breaks down, grocery stores can source formula from another business.

While consolidation has led to price increases through a stressed supply chain, it has also allowed corporations to raise their prices simply because they want to. **Without a competitor, corporate executives can just price their products however they want.** The only constraint is on whether consumers will buy the product at all. And in many cases (food, diapers, baby formula, gasoline), consumers do not have a choice of whether to buy or not.

For further discussion of the problems of corporate consolidation, see the CPC Center's *antitrust explainer*.

Financialization Reduces Investments in Supply Chains

The trend in corporate consolidation is compounded by increased financialization, where more and more corporate profits come from moving money between investors and corporate executives, rather than from worker productivity. **Over the past half-century, investors have focused on maximizing short-term shareholder value, rather than supporting jobs and communities.** This is why, at the height of the pandemic, the stock market continued to improve, while unemployment soared.

Investors have used legal and financial systems to redirect profits, even when corporate executives pursue worker-friendly policies. They have downgraded stocks when management was unwilling (or unable) to cut worker pay. And while executives do legally have significant leeway in their business decisions, activist investors have leveraged the obscurity of corporate law to threaten businesses into maximizing short-term profits for shareholder gain. For example, under pressure from Wall Street investors, Union Pacific Railroad closed a Chicago sorting facility in 2019—right before the pandemic. This led to delays so severe that, in the midst of the supply chain crisis, Union Pacific suspended traffic from West Coast ports. The strain was exacerbated by divestment from rail workers: a regulator noted that the industry cut the workforce by 25 percent to meet Wall Street's profit goals.

Short-term profits almost always come at the expense of workers and further investments in the business. **For example, instead of using profits to raise workers' wages, corporations often give the money to shareholders in the form of dividends.** Dividends are distributed based on the proportion of shares an investor owns, so many executives buy stocks back in order to raise the value of the remaining shares. Again, this results in profits going to wealthy financiers rather than to wages or other investments in the company that might provide resilience during hard times.

The biggest airlines—American, Delta, Southwest, and United—spent $45 billion on stock buybacks between 2014 and 2019. This refusal to invest in their own resilience meant that when the pandemic crippled the airline industry, Congress had to spend $25 billion to bail it out. Even now, as wages fail to keep pace with inflation, stock buybacks are soaring: a record $300 billion in the first quarter of 2022. That means for the first time in history, stock buybacks are expected to exceed $1 trillion by the end of the year.

For these reasons—efficiency maximization, worker shortages, corporate consolidation, and financialization—the supply chain had little slack when a massive shock came.

A Pandemic Upends Operations, Corporations Take Advantage

Decades of policy choices made the collapse of our global supply chains inevitable. With all redundancy stripped from the entire economy, any shock would cause huge effects. That the collapse was the result of a global health crisis is unconscionable:

millions of people have now died because they didn't have access to life-saving equipment. And most of the blame can be placed on corporate greed.

So how does this lead to inflation? Prices do rise when there are too few products available for purchase. Under capitalism, scarce products are allocated according to who can pay for them—and so prices increase. This is why early economic predictions suggested that inflation would be temporary. As soon as the supply chain adjusted to the "new normal," economists suggested, prices would return to pre-pandemic levels. While the supply chain remains stressed, the situation has improved—yet it is unclear whether companies will lower their prices proportionally.

In most industries, prices rise a lot faster than they fall. Economists refer to this as the "rocket and feather effect" because businesses quickly raise prices during times of stress, but lower them very slowly when that stress disappears. In other words, prices rise like a rocket, but fall like a feather. This is partly because companies take advantage of people's expectations that prices *should* be high, even after their costs have declined.

Corporations are well-positioned to take advantage of these expectations. Most consumers have little knowledge of how smoothly (or not) international supply chains are operating, so they cannot know how much of a price increase is due to legitimate cost increases and how much is due to profiteering. **This uncertainty allows corporations to raise prices as much as they want, with little regard to consumer welfare.** And we know this is happening because corporate executives are bragging about it in their shareholder meetings.

Chevron (oil), Steel Dynamics (steel), Nutrien (fertilizer), Nike (apparel), and Keurig-Dr Pepper (soft drinks) all reported enormous profits, noting that they far exceeded increased supply chain costs. Chipotle (fast food), Hersheys (chocolate), 3M (masks), and Tyson Foods (meat) explicitly stated that their companies' profits would be tied to price hikes. Hostess's (bakery) CEO went further and told shareholders "when all prices go up, it helps." A Kroger (grocery) executive even told investors "a little bit of inflation is always good in our business." In fact, more than half of retailers admitted that they are using the cover of inflation to price-gouge consumers and secure higher profits for shareholders.

These examples show that a large portion of price increases is due to corporate executives willfully scamming hardworking Americans out of their recent wage gains. **To be precise, corporate profiteering has accounted for almost 54 percent of price increases since the height of the pandemic.** The Security and Exchange Commission reports that the median corporation's profits have increased by 49 percent over the same period. Billionaires' personal fortunes have increased as much since the start of the pandemic as they did for the 23 years prior. And there is very little stopping these trends from continuing unless state and federal governments act to curtail it.

Real inflationary pressures do still exist—even if they are exacerbated by corporate malfeasance. Supply chains remain stressed and opaque, insulating corporation price hikes. Russia shows no sign of abandoning its Ukraine offensive, meaning the global supplies of both natural gas and food will remain low. And Shanghai's lockdown is only just starting to ease, meaning an enormous production center has lower-than-usual capacity.

What *Isn't* Causing Inflation

Many voices have called for austerity as a response to today's inflation—the typical solution prescribed by those who see inflation as a problem of "too many dollars chasing too few products." But inflation is already squeezing workers, families, and communities across the country and threatens to undermine our economic recovery. If austerity is the appropriate response, policymakers must be able to show that inflation is due to government spending and higher wages. Yet all evidence points to the contrary.

The U.S. government's pandemic response legislation saved lives and businesses, but did not affect inflation. Even in the wake of the record-level spending in the American Rescue Plan Act, most rich countries are experiencing similar levels of inflation to the U.S. **If government spending were the problem, the U.S. inflation rate would be *well* above other countries'—none of whom passed a bill of a similar size.**

Additionally, there is no evidence of a wage-price spiral. A wage-price spiral can occur when wages rise, forcing businesses to raise prices to pay their workers better. This causes workers to demand higher wages in order to afford the increased prices—which results in further price increases.

However, employers are not raising prices to accommodate rising labor costs, but rather taking advantage of an opportunity to profit from market uncertainty. **Labor costs (wages) only account for 8 percent of price increases, which means that wage increases account for less than half a percent of inflation.** If rising wages had been the only contributing factor, inflation would have been between 2.5 and 4.5 percent in March (depending on supply chain constraints), instead of 8.6 percent. Furthermore, the May 2022 jobs report notes that wages have continued to decelerate—growing at less than half the rate of inflation.

Solutions to Rising Prices: Constrain Greed and Strengthen Supply Chains

Instead of eroding worker power and wages, policy solutions should ensure that when inflationary pressures ebb, prices will actually fall. Policies that approach rising inflation solely as a problem of "too many dollars; too few products" will inevitably fail to bring down inflation and will harm workers. Federal Reserve Chairman Powell has decided to control inflation by raising interest rates substantially, even if it comes at the expense of employment. This type of policy reduces workers' leverage, locks in supply chain stresses, and perpetuates the extreme inequality that characterizes the modern economy.

Taxes and Financial Regulations Reclaim Excessive Profits from the Wealthy

Instead, policy solutions should target the primary root of rising prices: corporate greed. Corporations are raising prices so that executives and shareholders can amass additional billions. Effective policies will tax away excessive profits, create a maximum wage, outlaw stock buybacks, tax the wealth of billionaires, and/or increase the tax rate for corporations and dividends. **These policies restrict employers' ability to extract profit from their companies at the expense of their workers and the public good.** They will incentivize employers to reinvest profits in their company and their workers.

Congress and the Biden Administration have proposed several actions along these lines, but none has yet passed. The Ending Corporate Greed Act taxes large companies that have profits in 2022 that far exceed their profits in 2015 through 2019. The Stock Buyback Accountability Act would tax stock buybacks. And President Biden's 2023 budget asks Congress to tax billionaires and raise the corporate tax rate.

Worker Protections and Childcare Investments Facilitate a Return to Work

Worker shortages in key supply chain industries (such as trucking) may be combated through several measures. Effective policies will ensure that workers who have left these industries can return, and that workplaces are held to common standards that provide workers with dignity. **The primary way we can facilitate a return to the workforce is to invest in child care and domestic workers.** The COVID-19 pandemic has left millions of people with a long-term disability, making the care worker shortage even more concerning. Many workers—primarily women—have been forced to stay home to take care of relatives, removing themselves from the traditional labor market. This domestic work must be either paid as any other job, or else other investments must be made into care infrastructure (child care centers, nannies, home health aides, etc). The latter would offload these duties to paid professionals, allowing workers to return to the traditional labor market. Domestic workers should also be given the full protection of the Fair Labor Standards Act, which currently excludes them.

Congress is making small steps toward this goal. Senators Murray and Kaine recently released a proposal to expand child care infrastructure. The proposal would open new child care centers, increase compensation for early childhood educators, and ensure that facilities are safe. Additionally, both houses of Congress have introduced the Domestic Workers Bill of Rights Act to protect domestic workers and home health aides.

The Fair Labor Standards Act also excludes independent contractors, who make up a bulk of supply chain workers. Independent contractors are often victims of wage theft, harassment, and other workplace hazards that are less common—though still concerningly frequent—among employees. Employer misclassification of workers also contributes to these phenomena. More stringent guidance on classification would prevent employer malfeasance, and better enforcement of the Department of Labor's wage-hour laws would ensure that, when workers do return, they receive payment for their work. And independent contractors must also be protected by these laws.

Many of these concerns would be alleviated by the Protecting the Right to Organize Act currently before Congress. It creates a simple test for whether a worker can be categorized as an independent contractor and provides remedies when an employer violates a worker's rights. Additionally, President Biden's 2023 budget includes a 16 percent increase in funding to the National Labor Relations Board—the body responsible for enforcing labor standards.

Another way trucker shortages could be addressed is by requiring trucking companies to pay for drivers' time. Currently, truckers are paid by the mile, meaning that any time they spend at warehouses is unpaid. Consequently, there is no incentive for shipping companies to quickly transfer products from the warehouse to the truck. Drivers can wait for hours for this transfer to occur—hours that are unpaid, and that could instead be used to actually bring products to stores. In other words, simply paying truckers for their time would incentivize shipping companies to fix the supply chain, rather than racking up record profits in "late fees," unpaid wages, and higher rates.

Antitrust Enforcement Reverses Consolidation

Corporate consolidation can be combated through antitrust measures. **Mergers and acquisitions must be regulated with an eye to market power, rather than relying on price**. And large corporations must be broken up to reverse decades of monopolistic mergers. Large multi-industry corporations should be prioritized in this effort, as they frequently cross-subsidize new ventures. For example, Amazon raised prices for its web-hosting services (an industry where it has a near monopoly) in order to reduce the price of Prime membership below what its competitors could afford.

There are three bills in Congress that aim to curb the monopoly power of cross-industry tech giants like Amazon: the American Choice and Innovation Online Act, the Platform Competition and Opportunity Act, and the Ending Platform Monopolies Act. These bills would, respectively, limit platforms' ability to privilege their own products, prevent them from buying out competitors, and require divestment from a product line if it creates a conflict of interest.

When evaluating mergers, the Federal Trade Commission and the Department of Justice should also consider the impact on the labor market. This will forestall corporate collusion that harms workers. The Biden Administration has pushed these agencies to be more aggressive in their enforcement of antitrust laws. President Biden's 2023 budget aims to support their efforts, with a 44 percent increase in funding. Focusing these efforts particularly on banks and other financial institutions will help to reverse the financialization that has resulted in disinvestment in businesses throughout the economy.

Supporting Families through Economic Crisis

While these solutions will help to build a more resilient supply chain going forward, undoing decades of corporate concentration and disinvestment will require aggressive action and a lot of time. No policy is going to suddenly straighten out kinks or resolve a crisis that has been building for nearly half a century. In the meantime, we must also act to ensure workers and families have what they need to weather economic crises.

Middle-income households could benefit from an increase in the overtime threshold—commonly referred to as the "middle-class minimum wage." Any employee paid less than the overtime threshold must be paid time-and-a-half if they work more than 40 hours in a week. Thus, it either increases the pay of these workers, or protects their free time. In the 70s, the overtime threshold covered more than 60 percent of workers, but now it only covers 8 percent. The Biden Administration could unilaterally raise it to $65,000 via executive action, effectively giving a raise to every worker below the median wage. This threshold should also be pegged to inflation to ensure that this support is durable and that further inflation does not erode it.

Low-income households would benefit from an increase in the minimum wage, or a locality-specific living wage. A country-wide $15 minimum wage—as proposed in the Raise the Wage Act—would provide a wage floor for most employees (though independent contractors, domestic workers, and agricultural workers are currently exempt from minimum wage and maximum hour laws). There is also evidence that a minimum wage puts upward pressure on wages throughout the low end of the wage distribution. This being the case, a minimum wage increase would raise wages for 21 percent of workers. As with the overtime threshold, the minimum wage must be pegged to inflation to ensure that rising prices do not chip away at these gains.

Fixed-income households should also have their benefits pegged to inflation. These families are those most harmed by rising prices because they cannot negotiate a higher income to compensate. Relevant benefits include social security payments, disability benefits, and all safety net programs—including unemployment insurance, food support (SNAP and WIC), and Supplemental Security Income. Congress has proposed tying social security payments to inflation in the Social Security 2100: A Sacred Trust bill. Congress could also implement nationwide price controls (particularly for rent, medications, and other necessities). Policies such as these would mitigate the effects of inflation on the most vulnerable Americans.

Finally, the right to organize for all workers should be protected and enforced. **Government must no longer be a neutral arbiter of unionization efforts and should actively support collective bargaining.** Unionization results in an average wage increase of 11 percent, and would balance out the power currently wielded by corporations. The Protecting the Right to Organize Act would protect unionization efforts from some corporate misbehavior, but the bill stops short of requiring the Department of Labor to support workers.

These policies would limit the harms of inflation, chip away at the power that the wealthiest Americans have consolidated for the last several decades, and reduce inequality. For too long, corporations and the wealthy have had a free hand to collect the profits and wages owed to the working class. Money has been stripped from the bottom 90 percent of workers through skyrocketing rents given to developers, exorbitant medication prices given to pharmaceutical companies, catastrophic insurance premiums, and now the rising costs of everyday products. It is long past time to secure Americans' incomes against price gouging as corporate executives use the cover of inflation to continue their profiteering.