Stimulus Spending a Factor, But Far From Whole Story on Inflation

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Economists cite several reasons for high inflation in the United States, starting with the unprecedented circumstances created by the COVID-19 pandemic. But TV ads in midterm races across the country blame one culprit: stimulus spending by President Joe Biden's administration.

That spending — the American Rescue Plan, enacted in March 2021 — has been a factor "and not an unimportant one," George Selgin, senior fellow and director emeritus of the Center for Monetary and Financial Alternatives at the Cato Institute, told us, echoing the view of other economists. But it "certainly has not been the whole story."

Meanwhile, Democrats aren't shy about picking favorites in the inflation blame game, either. Biden, as we've written before, focuses on the pandemic and Russia's invasion of Ukraine, saying, "it's not because of spending."

Asked whether both sides were oversimplifying the issue, Alex Arnon, associate director of policy analysis for the Penn Wharton Budget Model, told us: "That's an easy yes." Arnon went on to say it was hard to disentangle all of the elements affecting inflation.

With the latest figures showing that inflation rose 8.6% year-over-year in May, and in the wake of several interest rate hikes by the Federal Reserve to control inflation, the topic has, not surprisingly, become a theme of midterm ads attacking Democrats. In the month of June alone, 76 Republican TV ads mentioning inflation started airing, according to Kantar, which provides data on political advertising.

Republican Sen. Ron Johnson and the National Republican Senatorial Committee, for instance, launched a TV spot on June 22 that claims "$5,000 a year" is "the burden of Joe Biden's inflation tax on Wisconsin families." That figure is a Bloomberg Economics estimate, published in late March, for how much more a U.S. household, on average, would have to spend for the same basket of goods in 2022, compared with last year, due to inflation. But the estimate doesn't break down the dollar amount by the inflationary factors causing the price hikes. It notes increased savings and higher wages would "cushion those costs."

Johnson's TV ad, though, only mentions "Biden's massive deficit spending" for causing higher grocery and gas prices. The campaign pointed us to a Vox article from May that — as we do here — explored how much of a role the American Rescue Plan has played in inflation. It noted the United States' problem was "more severe, to at least some extent" than inflation in other countries due to higher amounts of stimulus here. But that doesn't mean Bloomberg's $5,000 average cost estimate is pinned all on Biden, as the ad suggests.

Similarly, a string of ads from a group called One Nation says that a "liberal spending spree" is "jacking up inflation," that "the highest inflation in 40 years" was "triggered by a massive surge in government spending" or that this spending "raised gas and grocery prices over 8%." The ads are airing in support of Johnson in Wisconsin and against Democratic Sens. Raphael Warnock in Georgia and Catherine Cortez Masto in Nevada. And in Alabama, Republican Katie Britt, who won the Republican primary runoff in late June, and a group supporting her used the inflation issue in ads blaming "Biden's liberal spending."

Economists have said the American Rescue Plan — a $1.9 trillion pandemic relief measure that included $1,400 checks to most Americans; expanded unemployment benefits; money for schools, small businesses and states — has contributed to high inflation, though estimates vary on how much. Jason Furman, a former economic adviser to President Barack Obama and now a Harvard University professor, told us his estimate is 1 to 4 percentage points and when "pressed for one number," he uses the midpoint of 2.5. Mark Zandi, chief economist of Moody's — whose work is often cited by the White House — said the impact of the stimulus measure now "has largely faded."

The ARP came after two other pandemic stimulus laws were enacted under Trump, worth a total of $3.1 trillion. That spending, too, could have contributed to inflation. (Selgin said more spending, other things being equal, makes prices go up, as does a shortage of goods.) But the concern, particularly with the March 2020 relief law, was squarely on boosting the economy and aiding the millions of Americans who lost their jobs. The ARP came later, on top of trillions that already had been spent.

The relief spending, however, is hardly the only inflation factor, with the fallout from the pandemic the root of the matter. And while most economists we spoke with said the American Rescue Plan should have been smaller or the money spent more slowly, they said some level of stimulus was needed. They noted there were positive economic effects to the measure, too, helping insure a robust recovery.

We'll go through the causes of inflation and what role the American Rescue Plan has played.

Causes of Inflation

The first factor, Arnon said, is that “obviously” the economy is coming out of “exceptional” circumstances. The shutdown of the economy during the early days of the COVID-19 pandemic in the spring of 2020, followed by the quick recovery was “unlike anything before.”

“It was pretty much inevitable … we were going to see some friction” that would mean higher prices, he told us.

Wendy Edelberg, director of The Hamilton Project at the Brookings Institution, who served on the president’s Council of Economic Advisers under Obama and George W. Bush, similarly said it all started with the pandemic. “I do think that in many ways [inflation] traces back to the pandemic because the pandemic has interacted with everything else that has happened to create the mess that we’re in,” she said. But “we wouldn’t be seeing what we’re seeing right now without other factors.”

Selgin said that earlier in the pandemic people were spending less, with fewer opportunities to spend. Plus, it was necessary for the government to take steps to allow people to have earnings. At the same time, productive activity was limited, which “makes goods more scarce,” he said. “Other things equal, that makes prices higher.”

And once spending picked back up “that lack of productivity would become more and more evident as a source of higher prices.” There were also consequences for the United States from the limit on world productivity, Selgin explained.

With supply shortages, increased savings in Americans’ bank accounts and a desire to avoid public activities due to COVID-19, people spent their money on goods. “We just gorged on goods,” is the way Edelberg put it, outfitting our home offices, acquiring home exercise equipment, buying more food to use at home and making other pandemic purchases.

In addition to savings from simply not going out and doing as many things, households received those government stimulus checks, three rounds of them. The CARES Act, enacted in late March 2020, gave up to $1,200 to Americans earning under $75,000 in adjusted gross income. At the end of 2020, Trump signed another COVID-19 relief measure that provided $600 to most Americans, well short of the $2,000 that both Trump and Biden wanted.

Two and a half months later, on March 11, 2021, Biden signed the American Rescue Plan, with $1,400 going to most Americans.

Edelberg said her reading of the data is that consumers “took that enormous fiscal support and while still not feeling comfortable with all of the face-to-face services, they focused their spending on goods,” a sector that “had already been pretty crippled by the extraordinary increase in goods spending throughout the pandemic.”

In some months, real — meaning inflation-adjusted — spending on goods was 15% above trend. “That’s crazy,” she said. “Even in the best of circumstances, our goods sector would not be able to keep up with that level of demand for that long.”

But it wasn't the best of circumstances. There were also labor issues, with workers out sick or not interested in working in some jobs, and supply issues with imports coming from other countries.

Edelberg said she does expect some decline in the prices of goods, because demand is now dropping. Consumers are starting to buy more services, however, and there's "very strong inflation in the services sector."

The chart below tweeted by Marc Goldwein, senior vice president and senior policy director at the Committee for a Responsible Federal Budget, shows personal consumption expenditures, for goods and services, above the trend line.

In 2022, these pandemic-related factors were "compounded very seriously by the Ukraine war and the sanctions that have been applied to Russia," Selgin said.

Furman told New York Magazine in May that "[n]o one expected 8.5 percent inflation. I don't think that would have been a reasonable thing to have thought. One point or more of our inflation, really, is Putin's invasion of Ukraine."

The "biggest story" over the past few months, Arnon told us, is energy prices, which dominate how the public thinks about inflation. It's "really hard to overestimate the impact in gas prices in how people experience inflation," he said.

He said there's "not an especially strong" link between the ARP and energy prices. The ARP contributed to demand, which affects demand for energy overall, but Arnon said such an impact would be "small."

As we've written before, experts have said higher gas prices aren't the fault of the Biden administration, but rather the result of pandemic-related supply-demand repercussions that have been exacerbated by Russia's invasion of Ukraine. Oil supply dropped early in the pandemic, and then struggled to keep up with surging demand. After Russia invaded Ukraine, several countries put sanctions on Russian oil and the U.S. banned imports completely.

According to the International Energy Agency, Russia is the largest exporter of oil to the global market, with most of those exports going to Europe. So the fallout from the conflict has affected global supply.

The May figures on the Consumer Price Index showed energy prices up 34.6% over the prior 12 months and gas prices up 48.7%. By comparison, food prices had increased 10.1%, and all prices minus food and energy (what's called "core inflation") had gone up 6%, according to the Bureau of Labor Statistics. (Go to the BLS page to explore the data further.)