Committee on Banking, Housing, and Urban Affairs, U.S. Senate

Subcommittee on Economic Policy

Hearing on “Protecting Consumers’ Pocketbooks: Lowering Food Prices and Combatting Corporate Price Gouging and Consolidation”

Testimony of E.J. Antoni

Public Finance Economist, The Heritage Foundation

Room SD-538 Dirksen Senate Office Building

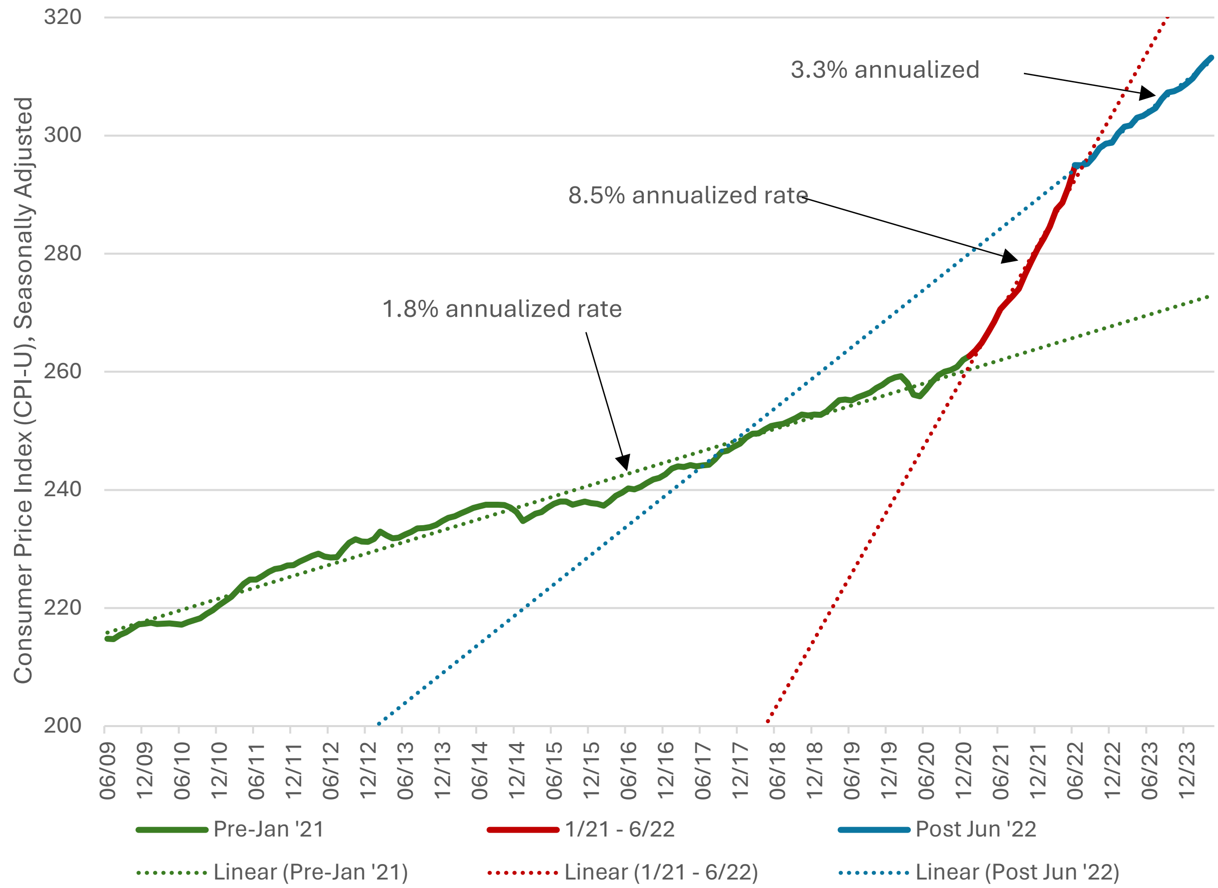
May 22, 2024

Chair Warren, Ranking Member Kennedy, members of the subcommittee: thank you for the invitation to discuss with you today food price inflation and the impact of public policy on American consumers, along with allegations surrounding corporate price gouging and consolidation. I am a public finance economist and the Richard F. Aster fellow at the Heritage Foundation, where I research fiscal and monetary policy with a particular focus on the Federal Reserve. I am also a senior fellow at the Committee to Unleash Prosperity.

Inflation and Food Prices Faced by the American Consumer

Since January 2021, American families have faced sharp increases in prices, especially for necessities like food. The consumer price index (CPI) published by the Bureau of Labor Statistics (BLS) has risen a cumulative 19.3 percent through April 2024 on a seasonally adjusted basis. That is an annualized rate of 5.6 percent, at which pace prices will double in less than 13 years. This is in stark contrast to the rate of increase in the CPI before January 2021. From the start of the previous economic expansion through December 2020, the CPI rose at an annualized rate of 1.8 percent, below the Federal Reserve's 2.0 percent target (figure 1). After January 2021, however, the CPI began increasing significantly faster and from that time through June 2022 rose at an annualized rate of 8.5 percent, more than 4.7 times the previous rate of increase. Since June 2022, the index has risen an annualized 3.3 percent, almost twice the rate before January 2021.

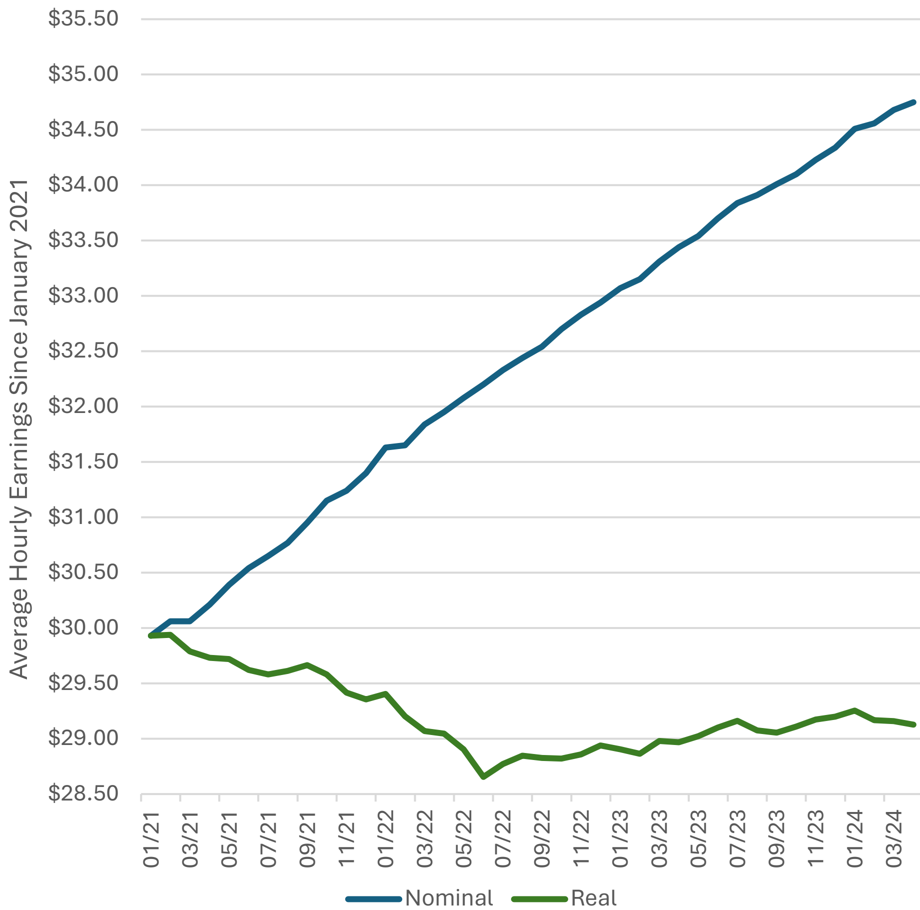
Figure 1



Source: Bureau of Labor Statistics

Over this same period, the average American worker's wage gains have increased less than consumer prices. Hourly earnings from January 2021 through April 2024 increased $4.82 on average, or 16.1 percent (figure 2). In real (inflation-adjusted) terms, average hourly earnings have declined $0.80, or 2.7 percent. That is a difference of $5.52 between the change in nominal and real average wages. Since prices have risen significantly faster than wages, the average worker's hourly compensation can buy less today than in January 2021.

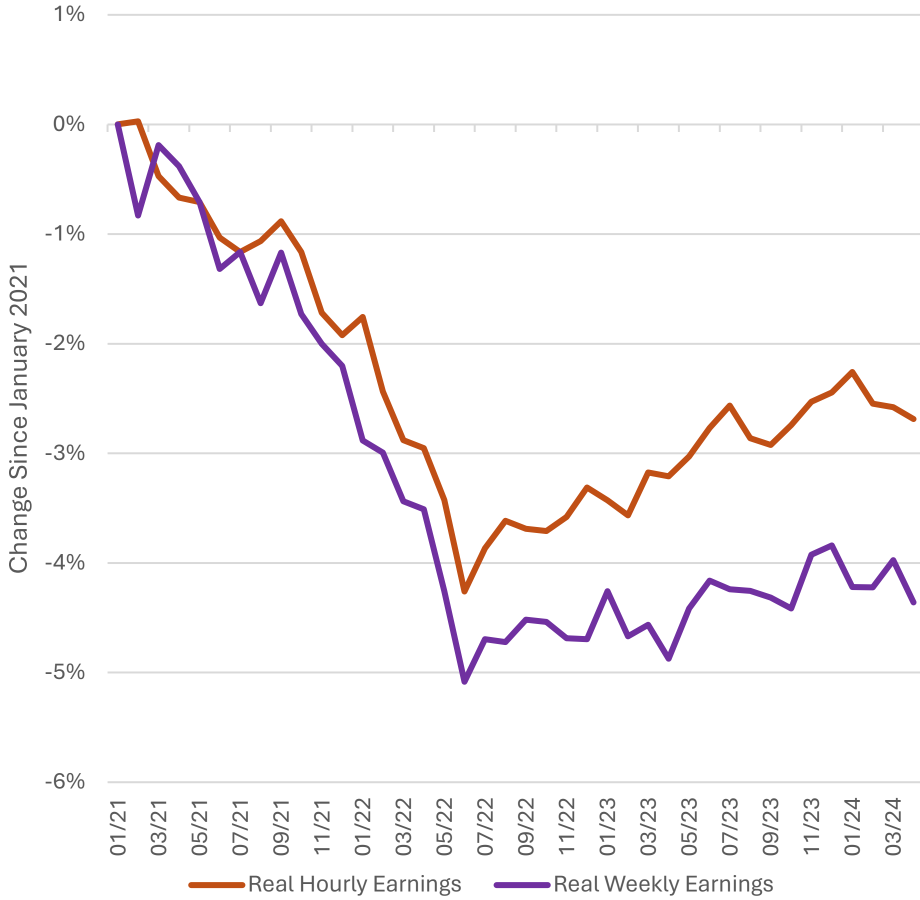
Figure 2



Source: Bureau of Labor Statistics

The decline in average real earnings has been worse than the decline in hourly wages, however, as businesses reduce hours and as the economy has lost full-time jobs, replacing them with part-time work. Consequently, the average workweek has fallen, and real average weekly earnings are down more than real average hourly earnings. The average American's weekly paycheck in April 2024 was $147.37 higher than in January 2021, a 14.1 percent increase. In real terms, however, that same paycheck is $45.53 smaller, a decline of 4.4 percent (figure 3). For the typical American family with two parents working, that is a decrease of $4,588.28 in annual purchasing power.

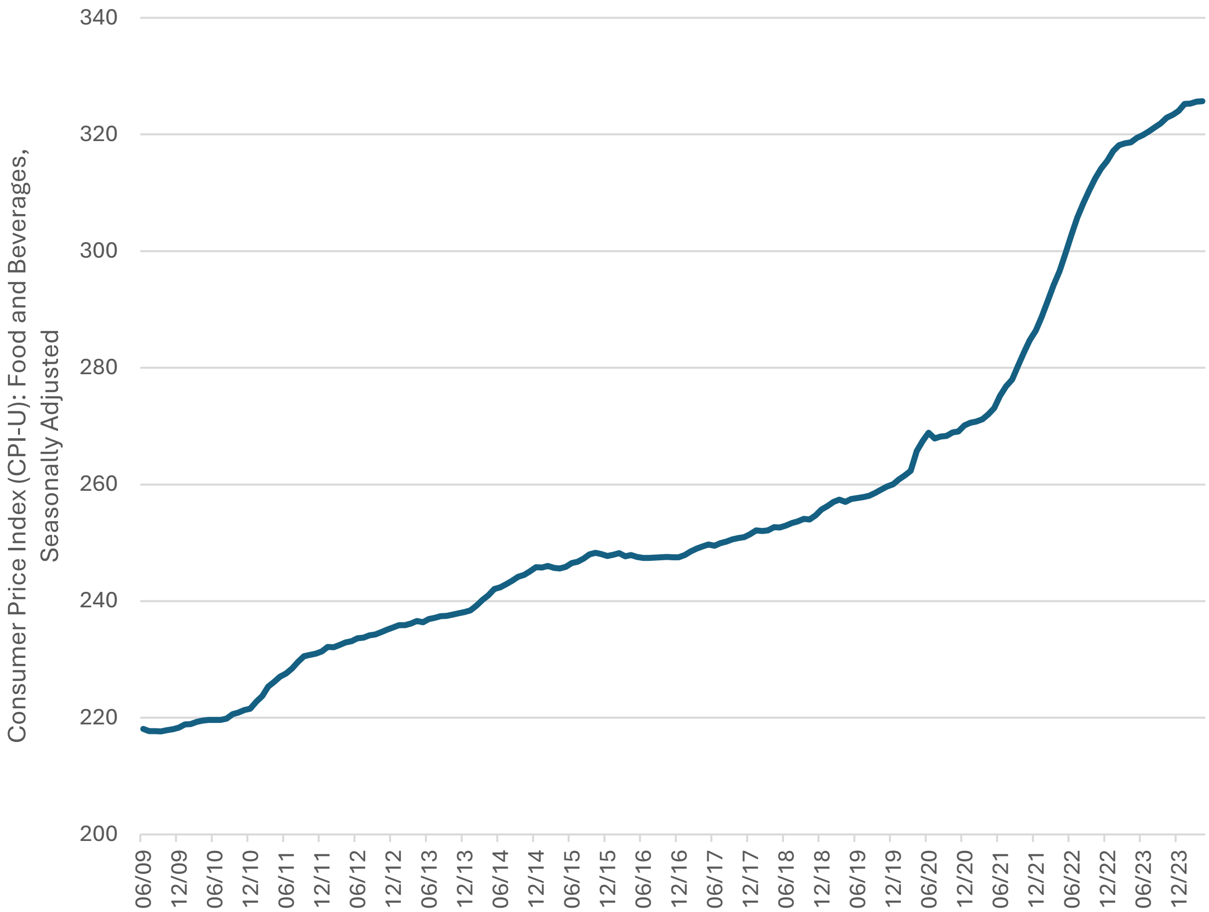
Figure 3



Source: Bureau of Labor Statistics

Food prices have risen even faster than the overall CPI since January 2021. From that month through April 2024, the average price of food and beverages has increased 20.4 percent (figure X). This is an average, however, and it should be noted that many consumer staples have increased in price significantly faster than 20.4 percent (figure 4). This is partly due to a substitution effect that is observed during periods of high inflation, such as American consumers have experienced since January 2021. In response to prices rising faster than wages, consumers change their buying habits, opting for relatively less expensive options. That represents a shift in demand towards those items which were disproportionately purchased by lower-income families previously. The increase in demand creates further upward pressure on prices, beyond the increase from inflation.

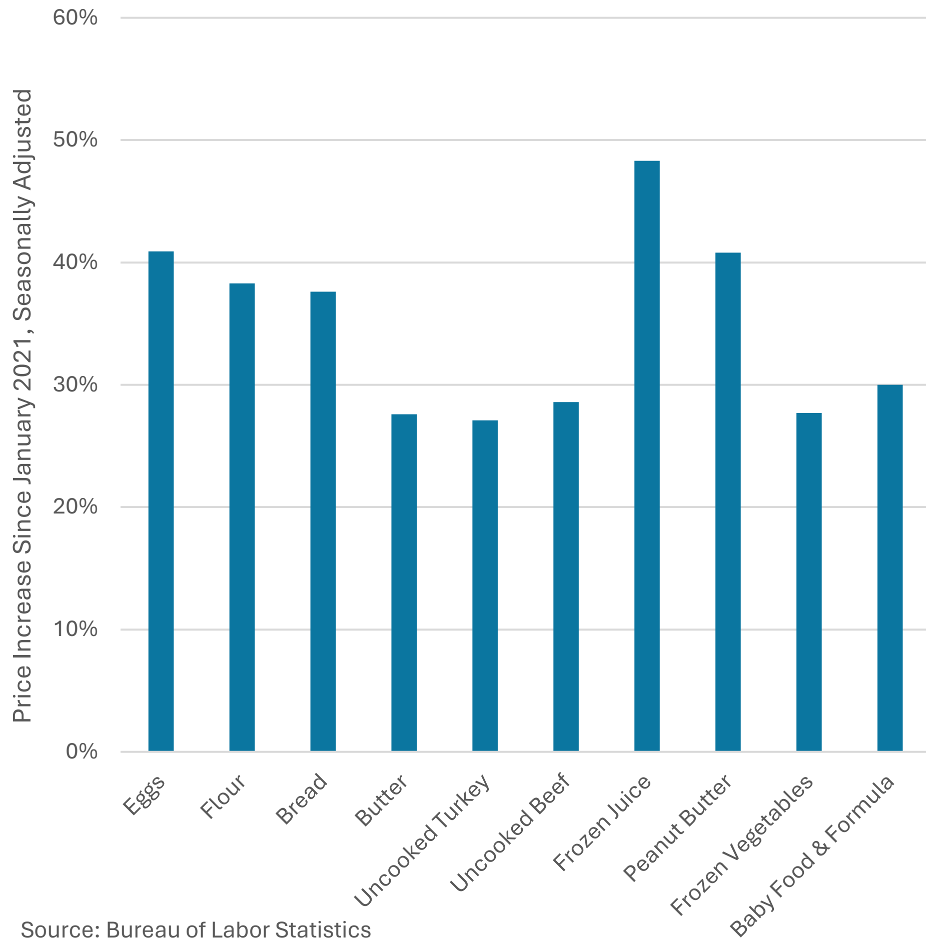
Figure 4



Source: Bureau of Labor Statistics

An example of this phenomenon is when consumers shift their buying habits from choice cuts of beef to eggs. Imagine a middle-class or a high-income family which previously purchased filet mignon occasionally. As food price inflation outpaces earnings growth, those families reduce the frequency at which they purchase this cut of beef and increase the frequency at which they purchase relatively less expensive meat, like ground beef. As this shift in demand puts additional upward pressure on the price of ground beef, consumers again shift to less expensive sources of protein, like eggs. Once again, an increase in demand causes prices to rise. The impact of these higher prices is felt most acutely by lower-income families for two reasons. First, a disproportionately large share of their budgets went to purchasing eggs. Second, they tend to have the least savings, and therefore margin, in their budgets with which to increase consumption spending. This substitution effect, in addition to the income effect of inflation, helps explain why prices of foods like eggs and peanut butter, traditionally inexpensive sources of protein, have risen over 40 percent since January 2021 (Figure 5). That is about twice the overall rate of food price inflation during that time.

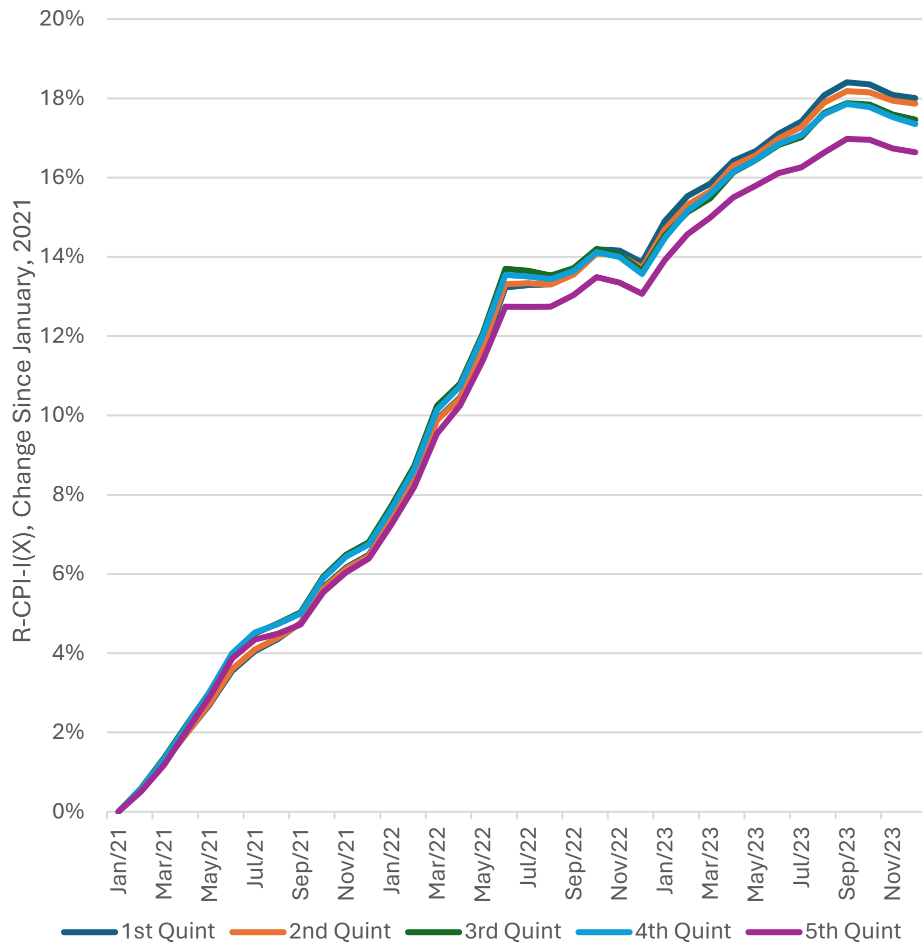
Figure 5



Source: Bureau of Labor Statistics

In addition to the CPI, the BLS provides price indexes representative of the baskets of goods and services purchased by people according to income quintile. From January 2021 through the end of 2023, the price index for the lowest income quintile has risen 18.0 percent (figure 6). As income quintile increases, the rate of inflation slows. The highest income quintile's price index is up 16.6 percent over that same time. The substitution effect described above has contributed to this disparity in the rate of price increases and demonstrates how inflation tends to fall most heavily on those least able to pay for it.

Figure 6

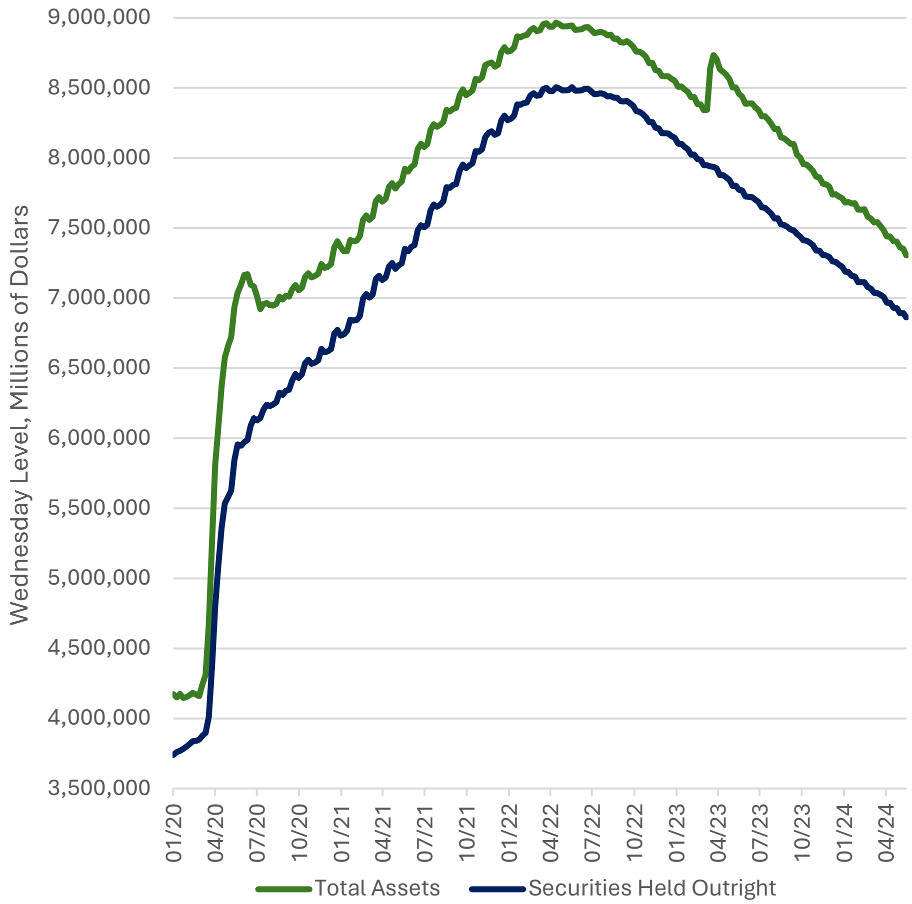


Source: Bureau of Labor Statistics

Causes of Food Price Inflation

Over the last four years, the federal government has run unprecedented budget deficits, resulting in equally unprecedented Treasury net debt issuances and an increase in the federal debt of $6.9 trillion since the end of 2020, and even more since the end of 2019. These debt issuances have largely been financed by the Federal Reserve's purchase of almost $5 trillion of Treasury securities since the start of 2020, along with manipulations of interest rates and capital markets to steer liquidity away from the private sector and towards the public sector (figure 7). Since purchases by the Federal Reserve are made from the right to issue fiat currency, they inherently increase the supply of money. Since the real economy has grown much slower than the money supply over the last several years, the value of the federal reserve note relative to goods and services has declined. This phenomenon is often referred to as "too much money chasing too few goods" and it is observed as an increase in the general level of prices.

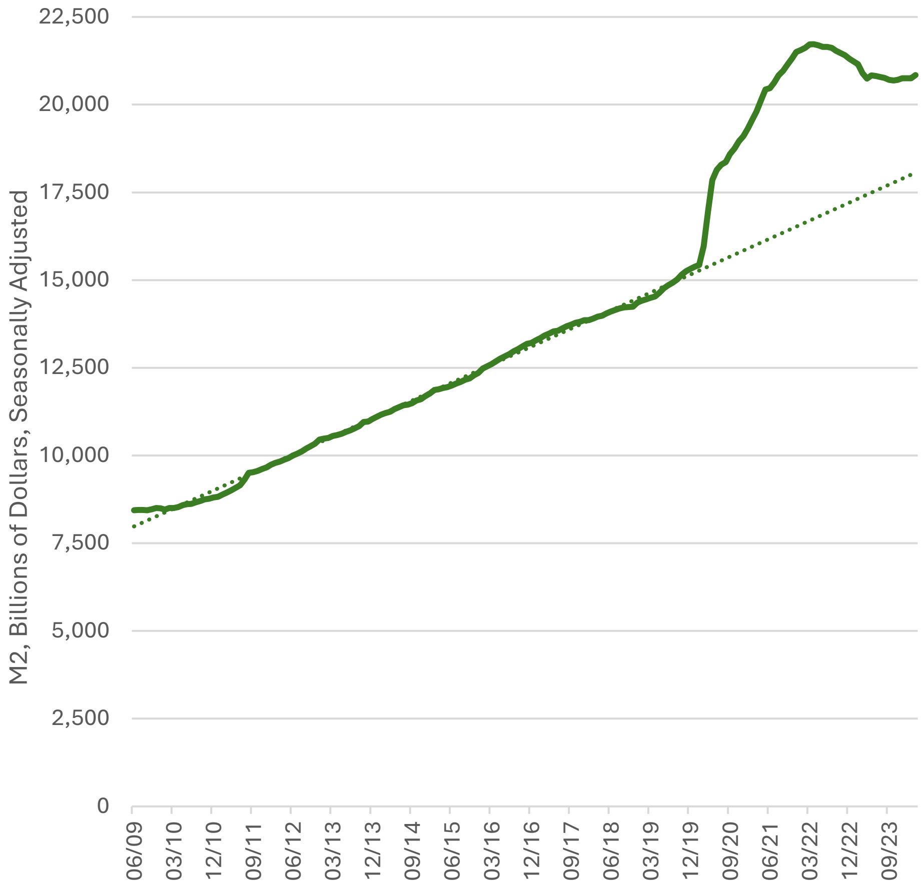
Figure 7



Source: Board of Governors of the Federal Reserve System

The quantity of money referred to as M2 grew over $6 trillion from early 2020 to the middle of 2022 (figure 8). After about a year of declines, M2 then remained relatively steady and has now begun growing again. It remains about $3 trillion above its pre-pandemic trend and is only down 3.9 percent from its peak as of March 2024, the latest data available at the time of this writing.

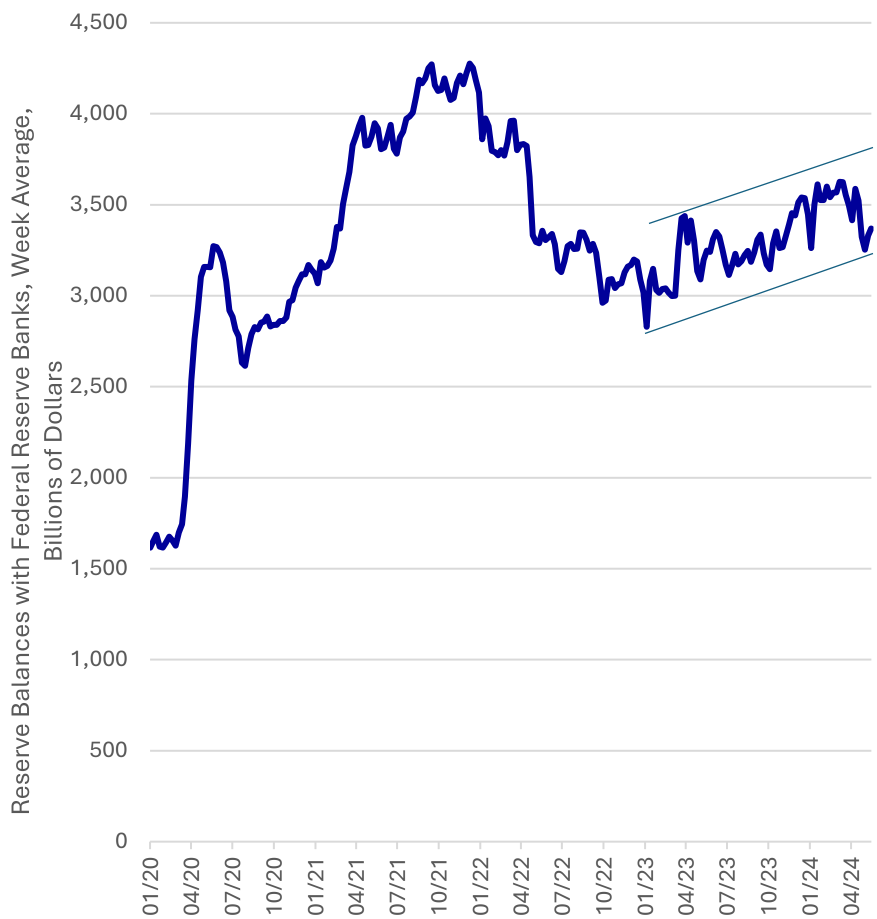
Figure 8



Source: Board of Governors of the Federal Reserve System

Similarly, bank reserves reached a trough at the beginning of 2023 and have trended up since then, rising 19.1 percent as of May 15, 2024 (figure 9). As this portion of the monetary base increases, loans to individuals, businesses, and the Treasury can increase, and each loan expands the total money supply. Thus, despite the Federal Reserve's reduction in its balance sheet, as seen in figure 7, the increase in bank reserves has continued to expand the money supply and maintain an inflationary impulse in the economy.

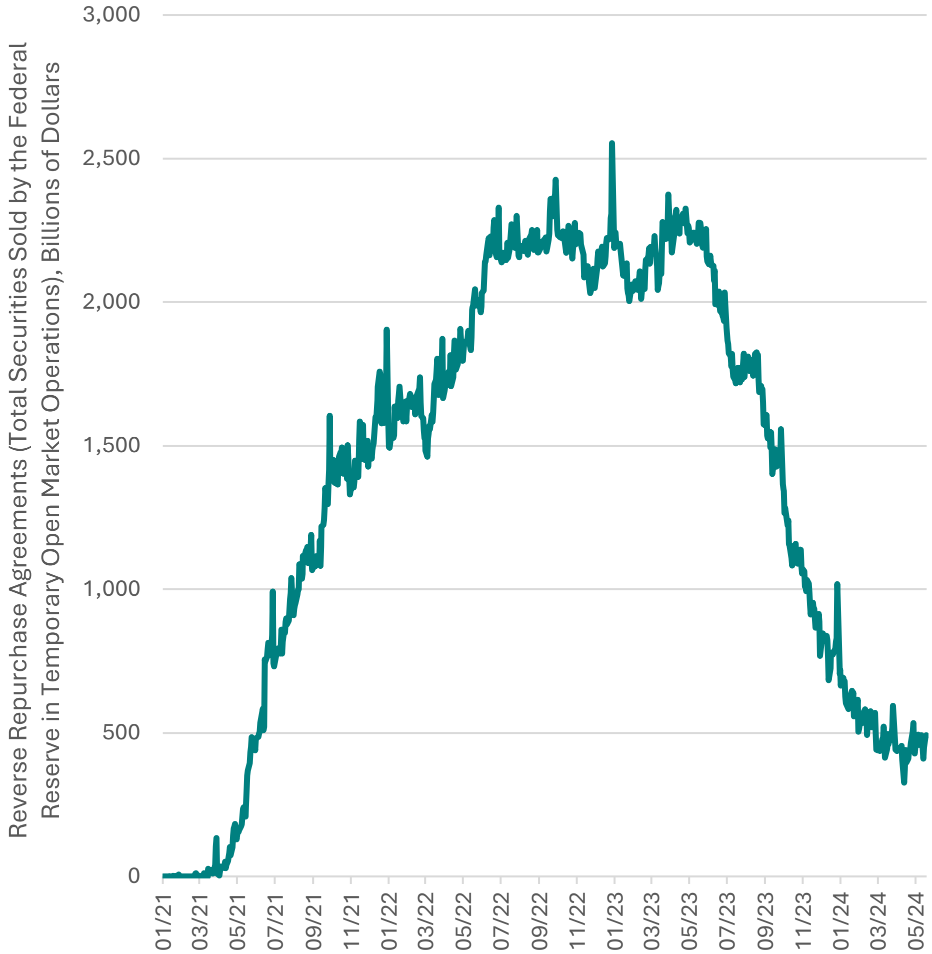
Figure 9



Source: Board of Governors of the Federal Reserve System

This is largely the result of continued net debt issuance by the Treasury which is expected to increase to nearly $900 billion in the third quarter of this year. As financial institutions cease lending to the Federal Reserve's reverse repurchase agreement (RRP) facility and instead lend to the Treasury, money is moving out of sterilization and is working its way through the banking system. Whereas the money in the RRP facility cannot be used as the basis for loans and therefore can enlarge the money supply, any money lent to the Treasury is spent and therefore can enlarge the money supply upon reentry into the banking system. Beginning in 2021, the RRP facility absorbed excess liquidity that had been created by the Federal Reserve from its purchase of Treasury securities (figure 10). That reduced the initial inflationary impact from government deficit spending in 2021 and 2022 but only by delaying that inflation. As the RRP facility drains, the economy is finally feeling the effects of the government deficit spending that began in 2021.

Figure 10



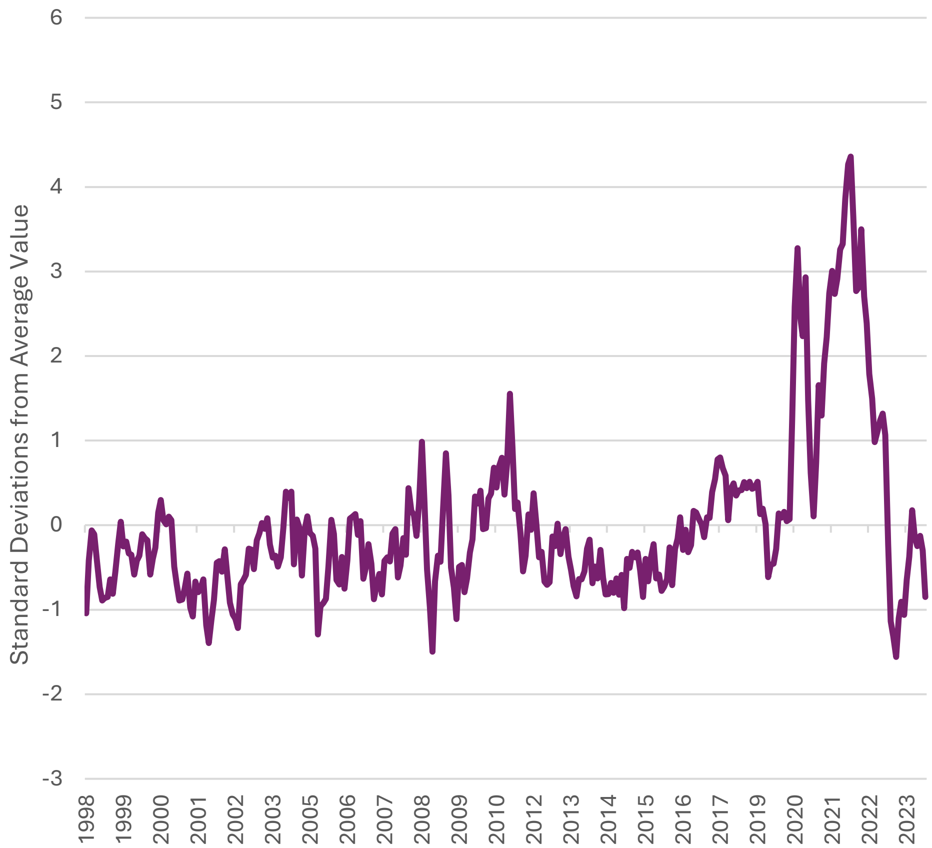
Source: Federal Reserve Bank of New York

The monetary phenomenon of inflation has not been the only source of price increases for food over the last several years. Government regulation, which has increased the price of food industry inputs, shares some responsibility as well. Regulations in the energy sector have been particularly harmful because of the wide variety of inputs which are created from natural gas, including synthetic fertilizers.

Incorrect Attributions for Food Price Inflation

Global and domestic supply chains experienced severe disruptions in 2020 due to government responses to the Covid-19 pandemic. That in turn caused certain prices to rise temporarily. As supply chain problems were resolved, however, those upward pressures on prices were removed. The global supply chain pressure index (GSCPI) shows a significant increase in 2020 followed by a return to average conditions by October 2020 (figure 11). The GSCPI then rose for most of 2021 but by February 2023 had fallen to below average levels. With the exception of November 2023, the index has been negative from February 2023 through April 2024. This indicates pressures on the supply chain remain less than the historic average.

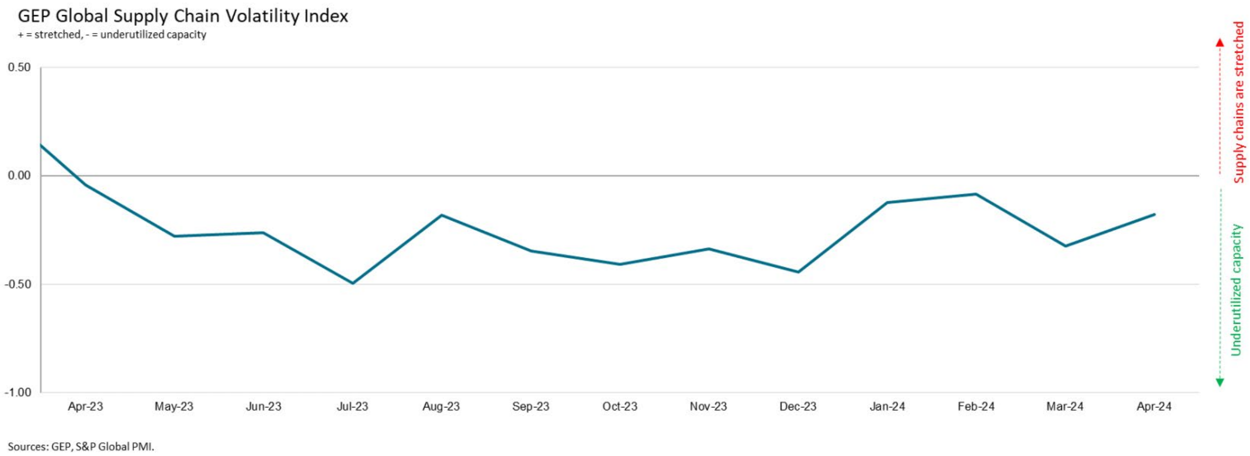
Figure 11



Sources: Baltic Exchange, Bureau of Labor Statistics, Harper Petersen Holding GmbH, Haver Analytics, IHS Markit, Institute for Supply Management, Federal Reserve Bank of New York, Refinitiv

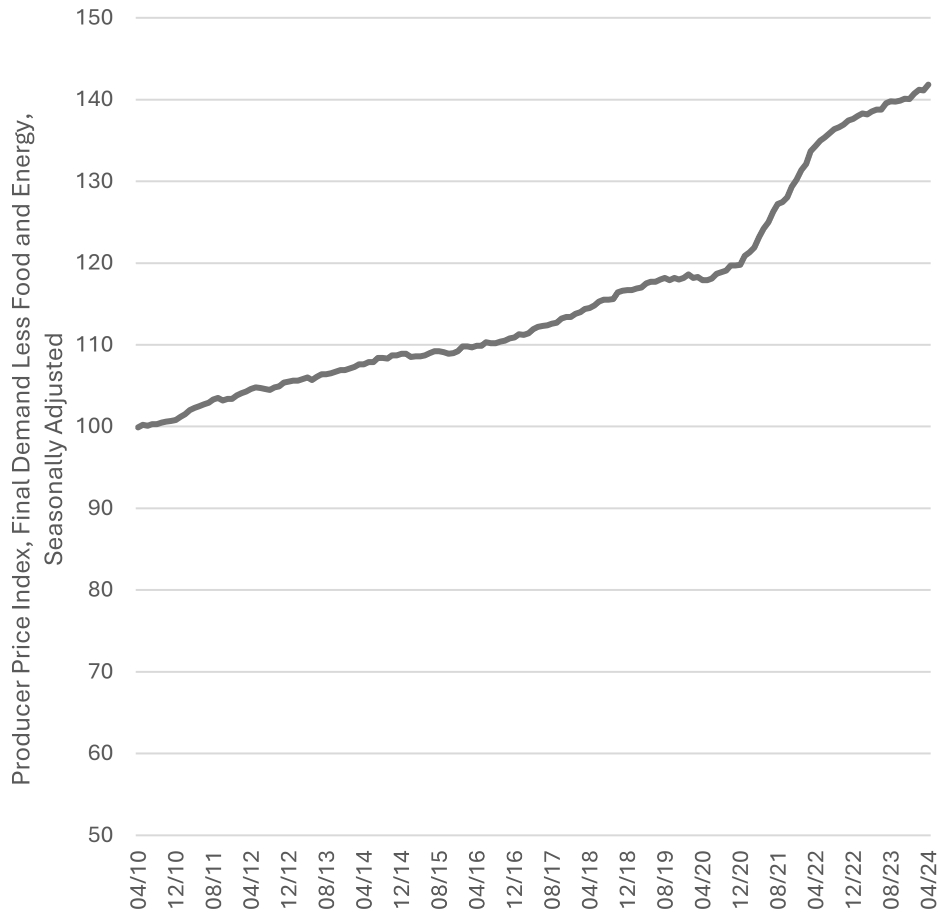
Similarly, the Global Supply Chain Volatility Index, published by S&P Global, shows that supply chains have had underutilized capacity for the last 12 months (figure 12). This underutilization reduces supply chain volatility as well as consumer prices.

Figure 12



If supply chains had been the driving factor behind food price inflation, then their stabilization and normalization should have not merely reduced inflation, but reduced prices as well, first at the wholesale level and then to consumers. This has not happened. Instead, wholesale inflation data, as measured by the producer price index published by the BLS, show prices paid by businesses continue to rise, even excluding the volatile food and energy categories (figure 13).

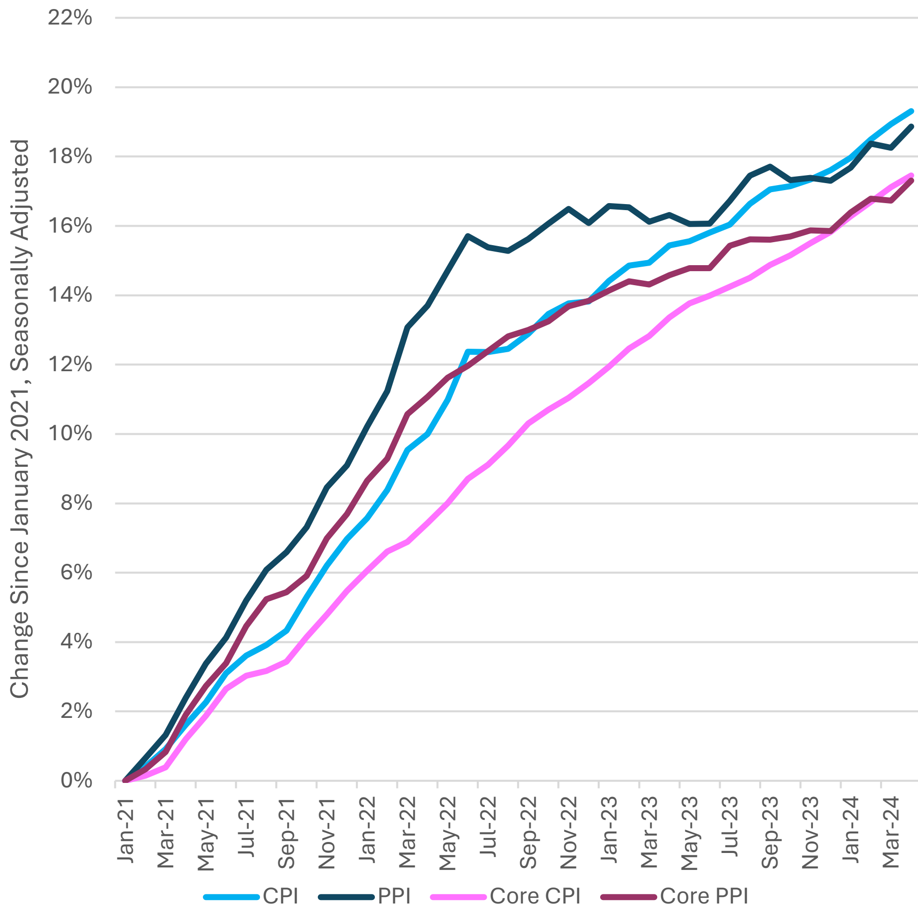
Figure 13



Source: Bureau of Labor Statistics

The comparison of consumer and wholesale price data raises another important point surrounding supposed causes of inflation. Since January 2021, both prices paid by consumers and prices paid by businesses have risen about 19 percent (figure 14). For nearly all that period, cumulative wholesale inflation was larger than cumulative consumer inflation. That means businesses were effectively shielding consumers from cost increases. It has only been within the last few months that the price increases paid by consumers have caught up to the price increases paid by businesses. The inflation, including the food price inflation, faced by American families is simply wholesale inflation being passed on to the consumer. In real terms, the lag between businesses paying higher prices and consumers paying higher prices has amounted to businesses shouldering 12 percent more of the burden of inflation since January 2021. Thus, the myth of "price gouging" is exposed as a mathematical impossibility.

Figure 14



Source: Bureau of Labor Statistics

Furthermore, the argument that corporate profits are driving inflation is equally fallacious. Corporate profits have increased compared to three and four years ago, but only in nominal terms. Adjusted for inflation, corporate profits have declined, not only broadly but in the food industry specifically. In the three years from the fourth quarter of 2020 through the fourth quarter of 2023, the most recent data available at the time of this writing, corporate profits within the industry rose 13.9 percent on average (figure 15). However, because inflation outpaced these nominal gains, those corporate profits declined in real terms over those three years by 4.2 percent. Once again, the empirical evidence fails to confirm the assertion that food price inflation is being driven by growth in corporate profit. Furthermore, the evidence clearly refutes this theory.

Figure 15

Sources: Bureau of Labor Statistics, Census Bureau

Corporate profits have increased in the same sense that the average American worker's weekly paycheck has increased: it has done so only in nominal terms. In reality, the hidden tax of inflation has transferred purchasing power from consumers and businesses alike to the government. Lastly, since the empirical data clearly show businesses are not the source of food price inflation, questions about consolidation within the industry become a moot point. The government is the only source of inflation because only the government controls the money supply. Similarly, it is the government which imposes regulation that further increases costs of production and consumption, including for food.

****

The Heritage Foundation is a public policy, research, and educational organization recognized as exempt under section 501(c)(3) of the Internal Revenue Code. It is privately supported and receives no funds from any government at any level, nor does it perform any government or other contract work.

The Heritage Foundation is the most broadly supported think tank in the United States. During 2022, it had hundreds of thousands of individual, foundation, and corporate supporters representing every state in the U.S. Its 2022 operating income came from the following sources:

Individuals 78%

Foundations 17%

Corporations 2%

Program revenue and other income 3%

The top five corporate givers provided The Heritage Foundation with 1% of its 2022 income. The Heritage Foundation's books are audited annually by the national accounting firm of RSM US, LLP.

Members of The Heritage Foundation staff testify as individuals discussing their own independent research. The views expressed are their own and do not reflect an institutional position of The Heritage Foundation or its board of trustees.