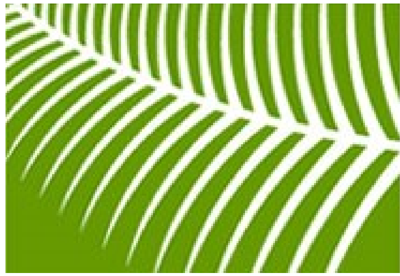

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US Price Inflation – Indexing and Summary

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This article summarizes the core points in three previous articles on US price inflation (*farmdoc daily, January 11, 2023*; January 18, 2023; January 25, 2023). Also discussed is the current indexing of a wide variety of government policies in whole or in part for inflation. Indexing, along with supply-demand imbalances in key sectors suggest that current US inflation may remain high for multiple years. Businesses should consider this possibility and the potential need to adjust their current management and operation.

Core Points in Prior Articles

Distinct, multiyear periods of US consumer price inflation have existed since 1950. The energy sector played a central role in the most recent high inflation period of 1973-1982. Energy also is playing a key role in current high inflation, but the percent increase in fuel and power prices has, so far, been less than in 1973-1982.

Metal and metal product prices are also currently increasing faster than average US producer prices.

During the last half of the 20th Century, cost of labor and farm prices moderated inflation by increasing less than US prices on average. However, since 2010, cost of labor has increased in line with average US prices while, since 2000, crop and animal prices have increased faster than average US prices.

Supply issues suggest both farm products and labor could contribute to higher US inflation over the next several years. Since 2000, US and World consumption has grown faster than yields of feed grains, oilseeds, and food grains. The US labor force may shrink over the next 10-15 years as more individuals exit than enter it. Also suggesting higher labor cost are US businesses' desires to reduce exposure to foreign supply chain risks and to rethink just-in-time production as well as the post-COVID lockdown desire of many US workers for greater work-time flexibility.

Indexing Inflation

One response to inflation has been to index government policy for inflation. They include:

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(1) benefits, eligibility, or other provisions of (Congressional Research Service, April 24, 2013):

1. Social Security
2. Supplemental Security Income
3. Medicare
4. Medicaid
5. Earned Income Tax Credit
6. Child Care Tax Credit (Refundable Portion),
7. Supplemental Nutrition Assistance Program
8. Child Nutrition Programs
9. Civil Service Retirement System
10. Federal Employees Retirement System
11. Military Retirement
12. Railroad Retirement Board
13. Unemployment Compensation by 33 states plus Washington, DC

(2) Federal tax brackets and other tax code provisions (Internal Revenue Service, October 18, 2022), and

(3) Minimum Wage by 13 states and Washington, D.C. (Kamper and Hickey, September 6, 2022).

Summary Observations

Inflation is a multi-faceted economic phenomena that economists do not understand well. It involves monetary variables and policy, which have not been discussed in these articles; too much demand relative to supply for some, maybe many goods and services; psychology and expectations about future inflation; and government policies.

Persuasive arguments can be made for each currently indexed US policy, but indexing not only shields affected sectors in part from needing to adjust to inflation but also means other sectors may have to make larger adjustments to bring inflation under control. Adjustment transference has rarely been discussed when implementing inflation indexing for an individual policy. It however becomes a bigger issue as more indexing occurs. In short, arguments can be made that indexing causes inflation by reinforcing inflation trends, particularly as indexing is applied to more sectors of the economy and government policies.

Should current US inflation prove to be high and multi-year, a looming US issue is differential spending paths for indexed vs. non-indexed government programs, especially given the indexing of many tax code provisions, which will tend to dampen the growth in government tax revenue.

History suggests high inflation is unlikely to be a one-year event. Energy, metals, labor, and farm sectors are important in current inflation. Their supply-demand balance suggest these non-trivial sectors could be inflationary for some years. Interest rate policy addresses supply-demand balances in individual sectors only crudely. Government policies that affect these sectors need to be examined closely for changes that can reduce individual sector inflation.

Predicting the economic future is difficult and likely to be error prone. Nevertheless, good reasons exist for thinking that current inflation could be difficult to bring under control and may extend over multiple years. If so, interest rates have at least returned to a more normal level and could remain higher than normal over multiple years. Prudent management suggests the latter possibility needs thoughtful

attention now. Businesses may decide that changes are or are not in order, but any desired / needed adjustment is unlikely to be instantaneous or will be less disruptive if implemented gradually as opposed to quickly.

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