How the Build Back Better Act Would Alleviate Inflation and Drive Sustained Prosperity

While the COVID-19 pandemic disrupted the economy in ways never before seen, the extraordinary stimulus measures of the American Rescue Plan successfully minimized the recession and facilitated a faster recovery. The American people have experienced some bumps along the recovery path, however, including unemployment for some groups and price increases for others.

These experiences point to the need for more federal investment in the economy's infrastructure, from roads and bridges to childcare—investment that would both alleviate inflationary pressures and create millions of jobs.

As policymakers continue to negotiate the scale and structure of the Build Back Better Act, they should remember these three facts:

1. **Most of today's price changes are temporary and sector-specific—driven by mismatches between supply and demand.**
2. **The Build Back Better Act invests public funding in long-standing, specific supply chain bottlenecks and market failures and would, therefore, relieve inflationary pressures.**
3. **The Build Back Better Act would set us on a trajectory of sustained economic prosperity and move us closer to full employment.**

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- Inflation is the increase in prices of specific items that are mainly due to temporary mismatches between supply and demand. It is a temporary cost of adjustment to a new higher level of capacity.
- Over the course of the COVID-19 pandemic, prices in some sectors of the economy have risen. Prices of items like lumber, used cars, and new cars temporarily rose this year due to a combination of supply chain bottlenecks, changing consumer preferences, and pent-up consumer demand. Other increases—in airline tickets and travel accommodations—have risen when compared to their drop early on in the pandemic, but not compared to previous price trends.
- Overall, these sector-specific price changes are the result of disruptions from the pandemic, the speed of the recovery from the pandemic, or ongoing issues of underestimating the potential of the economy.
- Many of these price increases have already subsided as supply has caught up with demand. From March to April 2021, used car prices increased 10 percent—their largest monthly increase since

the US began collecting used car price data. From April to June 2021, used car price increases were responsible for 22 to 33 percent of the overall month-to-month Consumer Price Index (CPI) increase. However, after three months of record price increases, used car prices stopped rising in July and dropped back down 1.5 percent in August 2021.

- While inflation in general has remained stable at the 2 percent target rate throughout the pandemic, three other groups of items—energy, vehicle-related, and pandemic-affected goods and services—have driven the overall decrease and/or increase in the CPI during the pandemic.

Figure 1

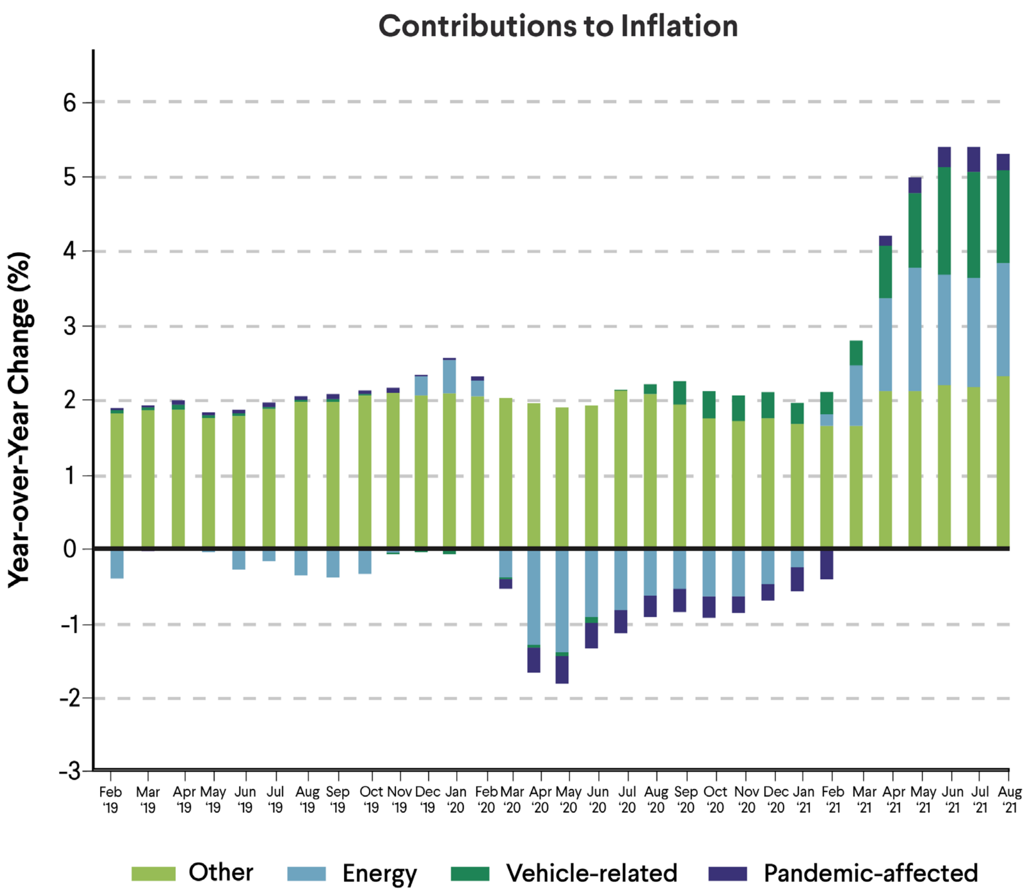

Figure 1 *shows groups of goods and services and their contribution to inflation throughout the COVID-19 pandemic. Pandemic-affected goods and services include airfare, hotel accommodations, and admissions to events. Source: Bureau of Labor Statistics, author's analysis.*

- Some industries are able to ramp up production to meet rapid increases in demand better than others. Prices of goods that are harder to quickly expand production of, like rental housing, will rise more in response to stronger demand, while prices of goods that can quickly increase production, like Netflix subscriptions, will rise less.
- The best policy response to inflation is to address specific price increases directly.

The Build Back Better Act invests public funding in long-standing, specific supply chain bottlenecks and market failures and would, therefore, relieve inflationary pressures.

Each component of the Build Back Better Act makes a targeted investment of public resources into infrastructure, or the supply side of the market, where the root causes of inflation lie. Some examples in the Build Back Better Act include:

- **Supply Chain Improvements:** The bill includes $10 billion for the Department of Commerce to invest in addressing manufacturing supply chain bottlenecks, such as the global shortage of semiconductors that drove up the cost of new cars in recent months.
- **Energy:** Energy costs have been a major contributor to inflation this year (see Figure 1). Energy costs will likely become more volatile as climate change advances, but investments in renewable energy and the technology to use renewable energy will help bring energy costs down in the short and long run. The Build Back Better Act includes $9 billion for whole-house energy saving retrofits and $7.5 billion to increase electric vehicle infrastructure, among numerous other investments in the nation's energy infrastructure. Together, these investments would allow Americans to transition away from the fossil fuel industry and its price volatility, which puts inflation on a roller coaster ride.
- **Childcare:** Convenient, affordable childcare is a major obstacle for working parents, illuminated even more so by school and daycare closures during the COVID-19 pandemic, which has disproportionately impacted women's labor force participation. Increasing the capacity of industries in order to curb inflation of specific prices requires increasing the supply of labor. The Build Back Better Act invests in existing and new childcare facilities in underserved areas and provides subsidies to make childcare more affordable for qualifying households. Together, these investments would increase the supply of childcare, create new jobs, and allow parents to get back to work.

The Build Back Better Act would set us on a trajectory of sustained economic prosperity and get us closer to full employment.

- Our economic recovery from the COVID-19 pandemic is far from over: 8.4 million people are currently unemployed, and the Black unemployment rate is still roughly twice the size of the white unemployment rate. Furthermore, there is uncertainty about how the Delta variant and recent cuts to expanded unemployment benefits will affect consumer spending and job growth.
- Even before the pandemic, there was a large gap between our economy's output and its potential. There is room in the workforce for 28 million people beyond 2019 employment levels. This would require 2 percent employment growth over the next 10 years.
- The Build Back Better Act would create over 4 million jobs per year, on average, over the course of a 10-year spending window, through direct public spending and increased indirect demand in related industries.

- In these uncertain times, when businesses are hesitant to make investments and households may reduce spending, the government needs to bear the risk and spend to close the output gap and fuel economic growth toward full employment.
- Without government spending filling the gap, demand is expected to fall dramatically next year, which could slow economic and job growth, locking in the pandemic's disproportionate job and income losses for women and Black and brown workers and households.

The Build Back Better Act commits the government to steady fiscal spending over the course of 10 years, focused on critical infrastructure that would pump money into the economy now, spur private sector investment and consumer spending, and expand the economy's capacity over the long term. It would increase the supply of childcare, create new jobs, and allow parents to get back to work.

In short, it's an opportunity we can't afford to squander.