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How should Oklahoma's Legislature respond to inflation?

As the primary actor in our country's fight in controlling inflation, the Federal Reserve is taking steps to curb inflation by tapering off their purchases of bonds and will likely raise interest rates within the coming year. These measures will take time to reach full effect to slow inflation.

Because the Federal Reserve controls the cost and availability of credit nationally, **there are virtually no economic or legislative actions that the State of Oklahoma can make to slow inflation.** Oklahoma cannot unilaterally tackle inflation because so much of our economy relies on other states and countries.

That said, our state's elected officials and policymakers can help low-income households — who are most vulnerable to high inflation — weather the inflationary storm until it passes:

- **Targeted tax relief would help to make up for the loss in buying power experienced by low-income households.**
    - This could be done through increasing the values of the Sales Tax Relief Credit or the Earned Income Tax Credit.
    - Policy solutions that put money back in the pockets of low-income households, though, would help low-income Oklahomans.
- **Broad-based tax cuts or rebates could make inflation worse**
    - Inflation is caused in part by increased demand for scarce goods and services. Policy decisions that broadly inject money into the economy will only further increase demand, which in turn will further fuel rising inflation.
    - While targeted tax relief to low-income families risks slightly increasing inflation, it would do so much less than across-the-board tax relief while keeping low-income Oklahomans afloat, making it a prudent policy option.

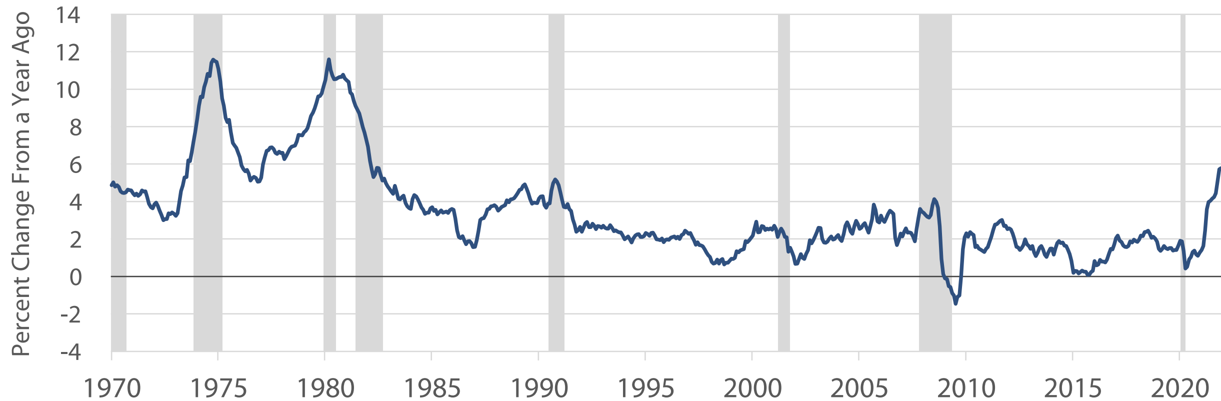
The best thing the Legislature can do is to provide economic relief to low-income Oklahomans who are least able to weather the inflation until supply chains return to normal and the Federal Reserve's tightening monetary policy takes effect.

Understanding Inflation

- Inflation refers to the increase in overall prices throughout the economy. If one business raises its prices, that wouldn't count as inflation. If large numbers of businesses raise their prices, that could contribute to inflation.
- Inflation is a constant fact of life in any economy and isn't necessarily a bad thing when controlled. The Federal Reserve's annual target for inflation is 2%.
    - In 2021, inflation was 7%, the highest it has been since 1982.
    - While inflation is currently high and requires a policy response to support low-income families, it is not at the near-historic levels seen during the mid-1970s and early '80s. (See graphic on page 2 for inflation's recent history.)
- High inflation is particularly dangerous to low-income families who are unable to weather the erosion of their buying power.
- State governments have extremely limited control over inflation.

Inflation is rising, but not at historic levels

Consumer Price Index; Shaded areas represent U.S. recessions



Source: FRED Economic Data and U.S. Bureau of Economic Analysis

What are general causes of inflation?

- There are two types of inflation, "cost push" and "demand pull"
  - **"Cost push"** is when the prices of business inputs (materials, rent, labor, etc.) increase, leading those costs to be passed along to consumers.
  - **"Demand pull"** is when demand (within a specific industry or the economy as a whole) increases but supply is unable to be increased to meet demand. In this case, the scarce goods and services go to the people who are willing to pay more for them in the form of increased prices.

Why are we seeing higher inflation rates now?

- Constraints on the supply chain increased production costs to businesses
  - The pandemic significantly disrupted global supply chains, making it more expensive to produce and ship finished products and component products.
  - As a result, businesses raised prices to account for these supply chain disruptions.
- Pent up demand from middle- to high-income consumers increased demand for scarce goods and services
  - Middle- to high-income consumers saved more money and had fewer opportunities to spend their disposable income, especially during the earliest days of the pandemic response when businesses closed, cities and states restricted activities, and travel plans were cancelled.
  - As businesses reopened and vaccine availability raised consumer confidence, this pent up demand began to be released, causing a surge in overall demand for goods and services
  - Because of supply chain constraints, businesses could not ramp up supply to meet the surge in demand, leading to higher prices
- How we measure inflation is overstating price increases in some sectors
  - Economists tend to measure inflation year by year.
  - Prices in some sectors (such as energy and air travel) dipped dramatically in 2020. As prices began rebounding last year, the resulting change made prices look as if they increased dramatically, when really they were just realigning to pre-pandemic levels.
    - E.g. National airfare prices rose 25% in 2021 compared to 2020, but they are still significantly cheaper than before the pandemic.