

The Supply Side Solution

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The media is fixated on an impending global recession and an inflationary environment around the world for the foreseeable future. However, every country is dealing with their own problems (all of which we will not discuss here) but the overall theme is inflation. Here at home, the economy is doing okay but across the pond Europe is suffering an energy crisis due to Russia's invasion of Ukraine and the UK is wrestling with the new Prime Minister Liz Truss's policies. The response to inflation in the U.S. has been a Federal Reserve that is resolved to reducing the rate back to 2%. We are near record-low unemployment today, but many economists are coming up with job-loss projections for this year and next based on the Fed's increasingly aggressive policy of pushing interest rates higher. The idea is that the Fed can get inflation down by forcing demand down resulting in a decline in inflation. In a world that is reeling from both the forced lockdowns from Covid and an energy shortage, the focus should be on generating growth not keeping a lid on it. The entire economic response to inflation has been to attack the demand for goods and services, forcing the economy to contract. But what about focusing on the supply of goods and services? Is this a viable option to quell inflation?

The traditional definition of inflation is too much money chasing too few goods. Today's 8% level of inflation is partly the result of the government's \$7 trillion response to the Covid pandemic (too much money) combined with a dramatic shortfall in goods due to supply-chain disruptions (too few goods). Policies to reduce domestic energy production have also been a major contributor to the increase in inflation. So, the options are two: either stifle demand or increase supply. There has been hardly any discussion about the supply side of the equation because the traditional solutions always revolve around impacting demand. As we have witnessed in prior economic downturns, the focus on demand is like putting the economy through detoxification. Remember gorging at Thanksgiving and paying for it later?

Today, the economy continues to expand. The latest GDPNow estimate from the Federal Reserve Bank of Atlanta is for a gain of 2.8% -- almost equal to the long-term growth trend; Since the economy is not overheating, the problem is inflation. The challenge is to keep the economy growing while reducing inflation down to more reasonable levels. To do that, turning to the supply side makes sense. The obvious first step is to increase domestic energy production through a roll-back of restrictions on the production of oil, gas, and coal. Second, resume construction of oil and gas pipelines. Third, open more federal land to drilling. Fourth, encourage (not discourage) investment in energy companies. Fifth, encourage individual states that have prohibited fracking to allow for this process.

Other important recommendations would be to encourage output by lowering prohibitive tax rates that stymie output. Ask states that have huge budget surpluses to use those funds to encourage production, not consumption. Most importantly, reduce or eliminate regulations that discourage production. These are just a few "supply-side" actions that will do a lot more for the economy than the traditional "demand-side" actions that clearly are not working.