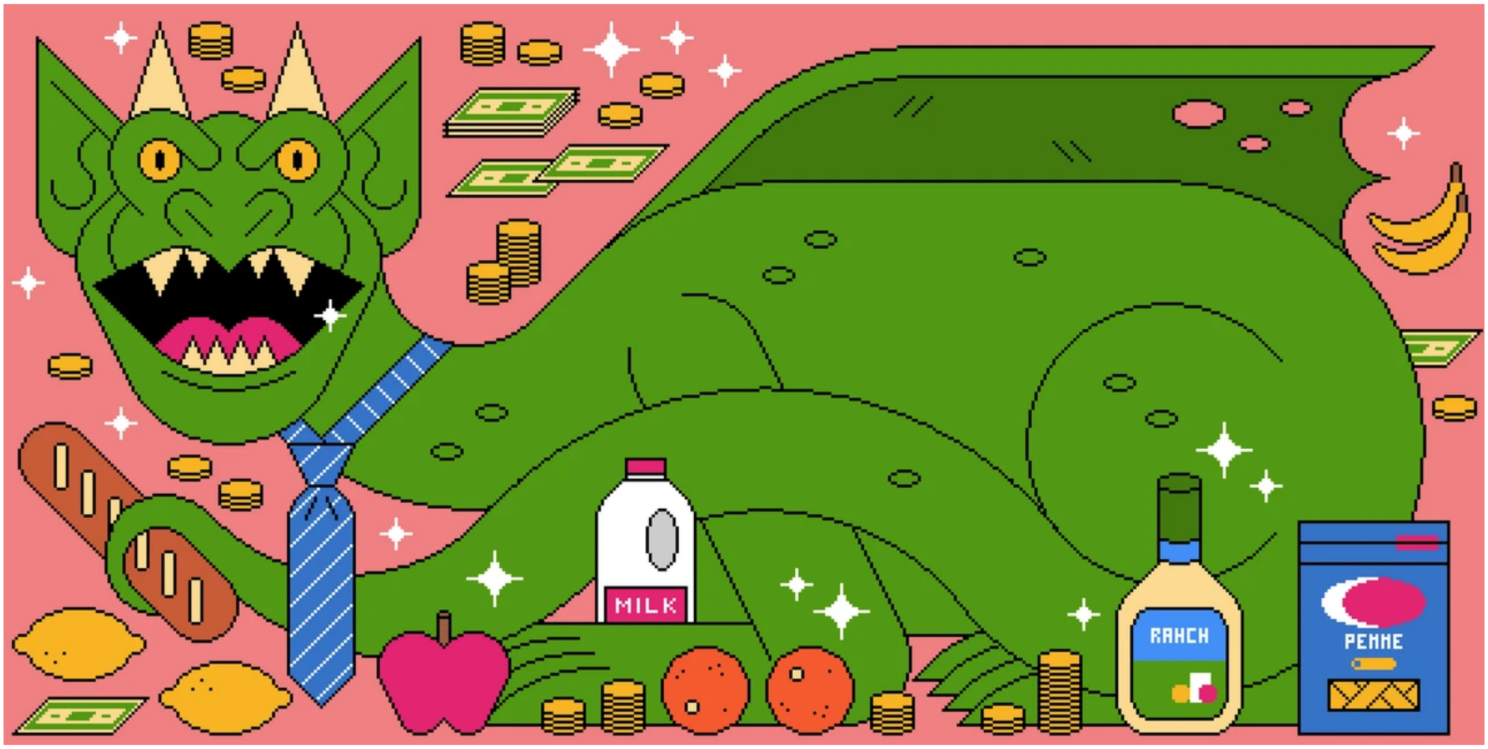
DISCOURSE ECONOMY

The real monster behind soaring prices

It's becoming clear that corporate greed is screwing over the US economy



Nick Little for Insider

Juliana Kaplan

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Drew has worked in the wholesale grocery business for over 20 years, making sure food hits the shelves on time and at the best prices. But nothing in his two decades in the industry prepared him for companies' response to the pandemic.

"Usually in the industry, a price increase would happen maybe once a year, maybe once every two years," he told me. But when COVID-19 hit, companies started raising prices every three to four months, which Drew said was "unheard of."

For a while, the price hikes made sense: Supply chains were snarled, manufacturers were paying more for the ingredients needed to make their products, companies were having to offer big wage hikes to lure workers, and consumers were buying everything in sight. But around

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October, Drew — whose last name is known to Insider but withheld over concerns about professional repercussions — noticed something odd. From what he could tell, cost pressures from the war in Ukraine and the supply-chain crisis were easing. There was inventory on the shelves and shoppers were doing less compulsive buying. Yet prices were still going up.

In the past, Drew said, food manufacturers' business success was gauged by how many products they sold. If they weren't selling enough, they'd offer deals to entice consumers. But instead of trying to sell a higher volume at a lower price point, it seemed as if companies realized they could raise prices and still bring in the same amount of money.

"They can sell half of what they need to sell, but they're hitting those profit numbers already," he said. While Drew told me he's seen prices stabilizing in 2023, there's one thing they're definitely not doing: coming down.

Anyone who has reached for a carton of eggs, filled up their tank with gas, or tried to buy pretty much anything has felt the sting of that inflation over the past few years. While many of the problems that helped trigger the upward spiral have abated, prices are still high and getting higher. The data is increasingly pointing to one culprit: corporate profit hoarding. And given the relative impunity big business enjoys, there may not be much relief for Americans' wallets anytime soon.

What goes up ... stays up?

The sudden economic stop-start of the pandemic caused a dramatic mismatch between supply and demand, fueling a once-in-a-generation inflation flare-up. But more than three years since the dislocations began, many of the logistical and labor messes have normalized.

Labor-market disruptions were a prime suspect in soaring inflation last year. Economists and the Federal Reserve suggested workers demanding higher wages was the "key" to inflation. But average hourly earnings grew by just 0.3% in March, according to the latest Bureau of Labor Statistics data, and currently sit at year-over-year growth of 4.2% — well below the nearly 6% jump from March 2021 to March 2022. Wages and salaries in the Employment Cost Index, a broader measure of employee compensation, have been on a downward march for roughly a year. The index rose just 1.2% from December 2022 to March 2023, barely above pre-pandemic levels and well below the pandemic peak from late 2021.

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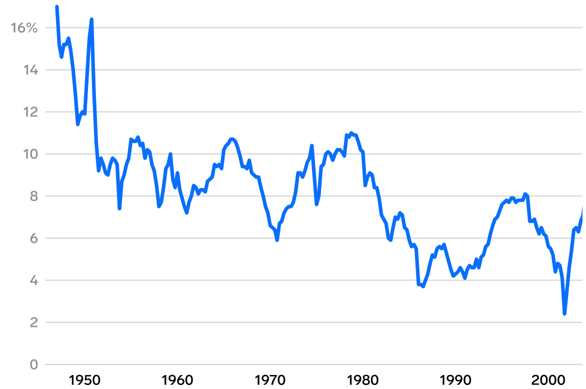
Another oft-cited inflation culprit, supply chains, have returned to normal. Freight-trucking prices peaked in spring 2022 and have tumbled close to pre-pandemic levels over the past year. In March, the Federal Reserve Bank of New York's global supply-chain-pressure index fell to its lowest level since 2008, and has been tumbling since December 2021. Chris Williamson, the chief economist at S&P Global Market Intelligence, found that the number of supply-chain delays fell yet again this January, reaching their lowest level since January 2020. And the excuse of shortages is a thing of the past: Retailers have been reporting an inventory glut for months as products pile up in their back rooms. Prices for raw goods that help drive companies' input costs have also declined from mid-2022 highs: Lumber and wood prices have been tumbling since February 2022; metal prices have been on a downward march since May 2022; and gas prices have cooled from their peak in summer last year.

Despite things getting back to normal, inflation remains high. The Consumer Price Index increased 5% year over year in March, its lowest rate since May 2021, but still roughly triple the average increase from the years leading up to the pandemic. While there are some technical reasons for CPI to be elevated, there are two important indicators that have not returned to normal: corporate profits and profit margins. Corporate profits hit a record high in the second quarter last year, and rose by 6.6% year over year. And corporate pretax profits reached record highs in the final quarter of last year. The biggest corporations in the S&P 500 also notched a record year for profits in 2022, according to data from the market analytics firm FactSet.

Corporate profit margins, which measure how much money a firm makes from sales after factoring in its expenses, also began soaring in the second quarter of 2020, and in 2022 hit their highest level since 1950. While margins have come down a bit since then, they still sit near 14% as of the fourth quarter of 2022. In 2019 and through the first quarter of 2020, profit margins sat just around 10%. So while there's no doubt that the economy has been through the ringer over the past three years, costs are finally coming down — and yet profit margins are still high.

US nonfinancial corporate profit margins



Note: Chart shows after-tax corporate profits as a share of nonfinancial corporate sector gr

Chart: Andy Kiersz/Insider • **Source:** Insider analysis of data from the Bureau of Economic A

What's beneath the inflation mask?

If inflation is the Scooby-Doo villain running amok, the "monster" underneath the mask is companies realizing that they can get away with charging more and more. The idea that companies are taking advantage of disruptions to push price increases on consumers has many names — greedflation, excuseflation, price gouging, corporate profiteering — but the gist is the same. Large corporations use the guise of disruptions to raise prices beyond what their costs would suggest is necessary or what economic theory would suggest is prudent, squeezing higher profits out of cash-strapped customers.

Supply-chain issues and other disruptions made sense as drivers of higher prices, Chris Becker, a senior economist and the associate director of policy and research at the Groundwork Collaborative, told me. But the degree to which companies pushed higher prices in an effort to not only pass on cost increases but also increase their profits and margins made it clear that corporations were just trying to "use this environment" to pad their bottom lines.

"We've seen that markups — the difference between the price that they charge versus the cost that they paid to produce the item — has also hit record highs," Becker said. "What it actually seems is that even though their costs are going up, their profit margins have also skyrocketed."

Some economists initially threw cold water on the idea of profit-driven inflation, suggesting that the fault fell on voracious consumers, raise-seeking workers, or government-support programs. But a new paper from the University of Massachusetts Amherst economists Isabella Weber and Evan Wasner argues that our current bout of inflation is what they call sellers' inflation. Bottlenecks — like those rampant supply-chain shortages — give firms what the economists call "temporary monopoly" status. Competition between firms in the industry, as well as the possibility of new companies trying to edge in on their territory, dwindles. And because many of these industries are so concentrated, with just a handful of companies dominating the market in any given area, it's easier for firms to reach an implicit agreement that, yes, they're all going to raise their prices.

Companies that don't fall in line and try to undercut their rivals to attract deal-conscious customers face discipline for not following the status quo. Wasner and Weber use the examples of Target and Walmart, which both tried to weather some costs without raising prices in an attempt to hold onto customer loyalty. This effort to keep prices low was greeted with disdain. Investors saw the price-hike-driven profits being made by competitors and sold off their Walmart and Target stock, in effect "penalizing their pricing strategy," according to Wasner and Weber.

Researchers at the Federal Reserve Bank of Boston similarly found in a 2022 study of inflation patterns that monopolistic concentrations in some sectors made price increases worse than they had to be. If there's no one challenging you with better deals or cheaper goods, you have free rein to hike prices as you wish.

> **If you have to pay more for your groceries, more at the pump, and more for your utilities, but everything else is also getting more expensive, you end up being squeezed**

At the same time, firms were able to hide behind myriad reports from news outlets (including Insider) amplifying just how bad supply-chain shortages were and that higher prices were a natural consequence of that. Paul Donovan, the chief economist for UBS Global Wealth Management, wrote in a November op-ed for the Financial Times, that "the power of storytelling has conditioned consumers to accept price rises."

"And consumers seem to be buying stories that seem to justify price increases, but which really serve as cover for profit margin expansion," he wrote.

When supply chains began to ease, companies found another useful red herring for the price hikes: Greedy workers who wanted more money were forcing them to raise pay, which forced them to raise costs. This argument, Weber and Wasner say, has it backward. Instead of workers driving inflation by asking for higher wages, employees were just desperately pushing to keep their pay comparable to the already-rising cost of goods.

"If you have to pay more for your groceries, more at the pump, and more for your utilities, but everything else is also getting more expensive, you end up being squeezed," Weber explained. "In such a situation people demand higher wages to protect their standard of living. Wage increases are, for the most part, triggered by inflation rather than the other way around."

As early as 2021, big companies began to explicitly signal that they were passing costs onto their customers. Gary Millerchip, the chief financial officer for Kroger, assured analysts during a quarterly earnings call in September 2021 that the firm had "a very robust process for how we manage when we see inflationary costs flowing through from suppliers" and was "very comfortable with our ability to pass on the increases."

And firms report that they're still seeing customers ready and willing to swallow their price hikes. Chipotle's chief financial and administrative officer, Jack Hartung, said in the firm's first-quarter-earnings call that menu prices have risen by about 10%, and chairman and CEO Brian Niccol said that they're "staying the course" on pricing — despite the fact profits were up 17% for the quarter.

"We're in a really strong position that when we're ready and we believe it's necessary to pull that pricing lever, we can," Niccol said.

There is no greed jail

So how do we discourage companies from using disruptions as an excuse to keep pushing up prices? The experts I spoke to offered a series of solutions — some carrots and others sticks.

On one end, there are policies that would punish corporations for implementing opportunistic price hikes. Weber and Wasner suggested national price-gouging laws that would prevent firms from hiking costs too much in significant sectors. Other economists and policymakers have proposed a windfall-profits tax, which would increase taxes on profits deemed excessive. On the other end of the spectrum are the carrot solutions that incentivize companies to expand their supply but make subsidies contingent on keeping end prices lower for consumers. Greater antitrust enforcement would also help to make it harder for companies to coordinate on pricing, Becker said. Despite the wide variety of proposals, none of the experts I spoke to were encouraged by the prospects of implementing these ideas for one big reason: politics.

There have been a number of politicians who have expressed willingness to more directly intervene to tame inflation. "I have revealed and called out giant corporations across the economy for hiding behind inflation to jack up prices," Sen. Elizabeth Warren of Massachusetts said in a statement to Insider. "Working people are suffering thanks to corporate greed, so we need to enact tougher rules to ensure corporations pay a price when they price gouge."

Despite the appetite in some corners of Congress, there's a vanishingly small chance for meaningful action. William Dickens, a distinguished professor of economics at Northeastern University, told me that it would be "impossible" to implement any meaningful inflation-fighting law in the current political environment. Even if Congress could agree on an idea and begin to roll it out, he said, the current bout of inflation "will be in the rearview mirror by the time that could happen."

> **Working people are suffering thanks to corporate greed, so we need to enact tougher rules to ensure corporations pay a price when they price gouge.**

That leaves inflation wrangling up to the Federal Reserve, with its blunt interest-rate tool. Raising interest rates works to reset inflation by crushing demand — mortgage and credit-card payments become more expensive, essentially forcing consumers to pare back their spending elsewhere. And as consumers pull back and it becomes more expensive for companies to get loans, firms shed workers, softening the labor market and wages. Instead of addressing the problem of inflation at its root, the hikes force everyone to suffer in order to rebalance the economy.

Josh Bivens, the chief economist at the left-leaning Economic Policy Institute, told me that there is hope. According to his research, while corporate profits' contribution to inflation is still outsized, accounting for a third of inflation at the end of 2022, it's finally normalizing — albeit at an excruciatingly slow pace.

"All this has definitely taken longer than I thought it would," he wrote to me.

In the meantime, though, consumers are left adjusting their budgets, cutting back, or racking up untenable amounts of debt as the food that they eat and the everyday goods they need remain more expensive than ever.

"It's really not corporations who end up paying the cost in the end because when their costs go up, they can just push that back onto consumers with higher prices and protect their profit margins," Becker said. "It's the consumers and the workers that really have ended up paying the cost for inflation."

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