

# Granular Markups and Inflation Surge: The Role of Managerial Incentives

Yuchen Chen, Juliana Salomao, Varun Sharma, and Yicheng Wang

Discussion by Kunal Sangani

## What caused the post-pandemic inflation?

- Demand?
  - Fiscal stimulus, pent-up savings, reallocation to goods, lax monetary policy?
- Supply?
  - Bottlenecks and supply chain disruptions? War? Convex supply curves?

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- Corporate greed?
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- ⇒ Chen, Salomao, Sharma, and Wang look for micro evidence on this question.

## Greedflation

- “Over the course of the year 2022, certain sectors [...] had taken advantage of, as you said, the mismatch between supply, constrained by bottlenecks and demand, enhanced by recovery, and a situation of everybody is in the same position, we’re all going to increase prices, which can be concerted practice, which can be just market-driven practices. In those circumstances, those sectors have taken advantage to push cost through entirely, without squeezing on margins, and—for some of them—to push prices higher than just the cost push.”

—Christine Lagarde, June 2023

- “We know prices are still too high because of what I call “greedflation” and “shrinkflation.” I’m calling on corporations to pass their savings on to consumers, for God sake.”

—Joe Biden, February 2024

# Greedflation

ECONOMY

## Economists are reconsidering how much corporate profits drive inflation

MAY 19, 2023 · 4:51 PM ET

HEARD ON [ALL THINGS CONSIDERED](#)

The New York Times

OPINION  
GUEST ESSAY

The New York Times

### **Inflation and Price Gouging**

We look at whether “greedflation” is causing higher prices.

## Fighting Inflation Means Taking On Corporations

THE WALL STREET JOURNAL

## ‘Greedflation’ Is Real—and Probably Good for the Economy

Companies have used inflation as excuse for big price increases, first-quarter earnings suggest

## The spiral is price-price, baby

By SAM SUTTON | 07/13/2023 08:00 AM EDT

## *Is ‘Greedflation’ Rewriting Economics, or Do Old Rules Still Apply?*

Economists and politicians are debating whether monopolistic companies are fueling inflation in ways that confound longstanding theory.

The New York Times

POLITICO

## *Are Big Profits Keeping Prices High? Some Central Bankers Are Concerned.*

Companies' rising profit margins could be contributing to persistent inflation, a European Central Bank policymaker says.

## Corporate Profit Markups Increased during the Pandemic and Are Driving Up Inflation

Increased costs and shortages explain some of the increased inflation. In some sectors, the shifts in demand discussed earlier are creating shortages that would result in higher prices even in competitive markets. But something else is happening. Companies are doing more than just passing on cost increases.

*“The Causes of and Responses to Today’s Inflation”*  
Joseph E. Stiglitz & Ira Regmi, 2022

## So is greedflation to blame?

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## So is greedflation to blame?

- “*[I think the theory that...] changes in gouging propensity are an important cause of inflation fluctuations are roughly ludicrous.*”  
—Larry Summers, March 2024
- Sources of skepticism:
  - Higher profits could also be due to high demand (operating leverage, inelastic customers).
  - Why would “propensity to gouge” change post-pandemic?
- Both theoretical underpinnings and empirical evidence wanting.
- Chen, Salomao, Sharma, and Wang offer new data on this question.
- Approach: Show how relative prices of public firms’ products change over 2021–2023.
  - Zoom in on manager incentives using stock-based CEO compensation, retail ownership.

## Reactions

1. What do changes in relative prices tell us?
2. The mechanics of raising prices: Greedflation, shrinkflation, cheapflation.

## 1. Relative prices

- Authors measure “markup premium” of product  $i$  in category  $c$  in  $t$  as

$$\log \mu_{ict} = \underbrace{\log p_{ict}}_{\text{Unit price}} - \underbrace{\log \alpha_{ct}}_{\text{Unweighted average}} .$$

- Underlying assumption: Marginal costs constant across products in category.
- Yoplait vs. Siggi's Icelandic Skyr.
  - Siggi's uses 3x as much milk per ounce of yogurt. Plus live cultures, packaging, ...
- In classic models, relative prices and markups often inversely related (e.g., Atkeson & Burstein 2008).
- “Relative prices” are interesting in their own right!

# 1. Relative prices

1. Relative prices means missing intercept problem is front-and-center.
  - Correlation of HHI, market size with “average relative price?”
    - *“The negative relationship between log(Sales) and markup [...] shows that as the size of the market increases, competition intensifies, leading to lower markups.”* [About Cov\(price, sales\)](#).
  - Treated firms raising price or untreated firms cutting price?
    - *“Column (1) shows that public firms raised prices by 0.6 percentage points more than matched private firms after 2020Q1 [...] providing] direct evidence that margin expansion was passed through to consumers, reinforcing the interpretation that public firms not only absorbed inflationary cost shocks, but actively amplified them.”*
    - Equally valid: private firms dampen inflation, drop prices when competitor goes public.

## 2. Unpack “black box” of relative price changes.

- Focus: incentives (retail share, stock-based comp.) and financing (quick ratio, leverage).
- $\Delta$  relative prices due to raising price, new varieties, fall in competitor prices, entry?

## 2. Greedflation, shrinkflation, cheapflation

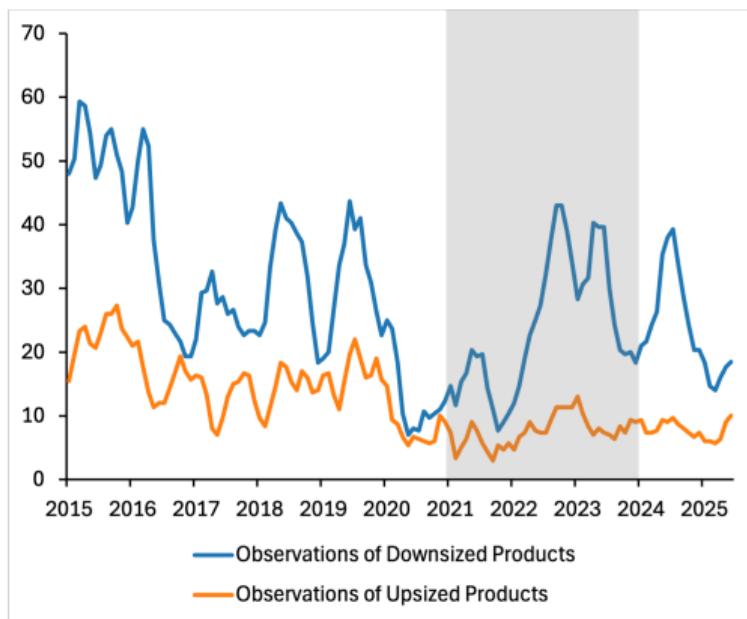
- Many -flation's: greedflation, shrinkflation, cheapflation...
- How would greedy corporations exploit confusion / latent pricing power?
  - Subtly change the size of packaging ("shrinkflation").
  - Increase prices most on consumers with fewest other options ("cheapflation").
- Perhaps inspecting these mechanisms can tell us about contribution of greed.
- Open the black box of price changes.

## 2. Shrinkflation

- “To offset increasing costs, we did not consider reducing the quality of our ingredients or the care we take in making your ice cream, sorbet, and frozen yogurt. We opted instead to slightly reduce some of our carton sizes.” —Häagen-Dazs, 2009

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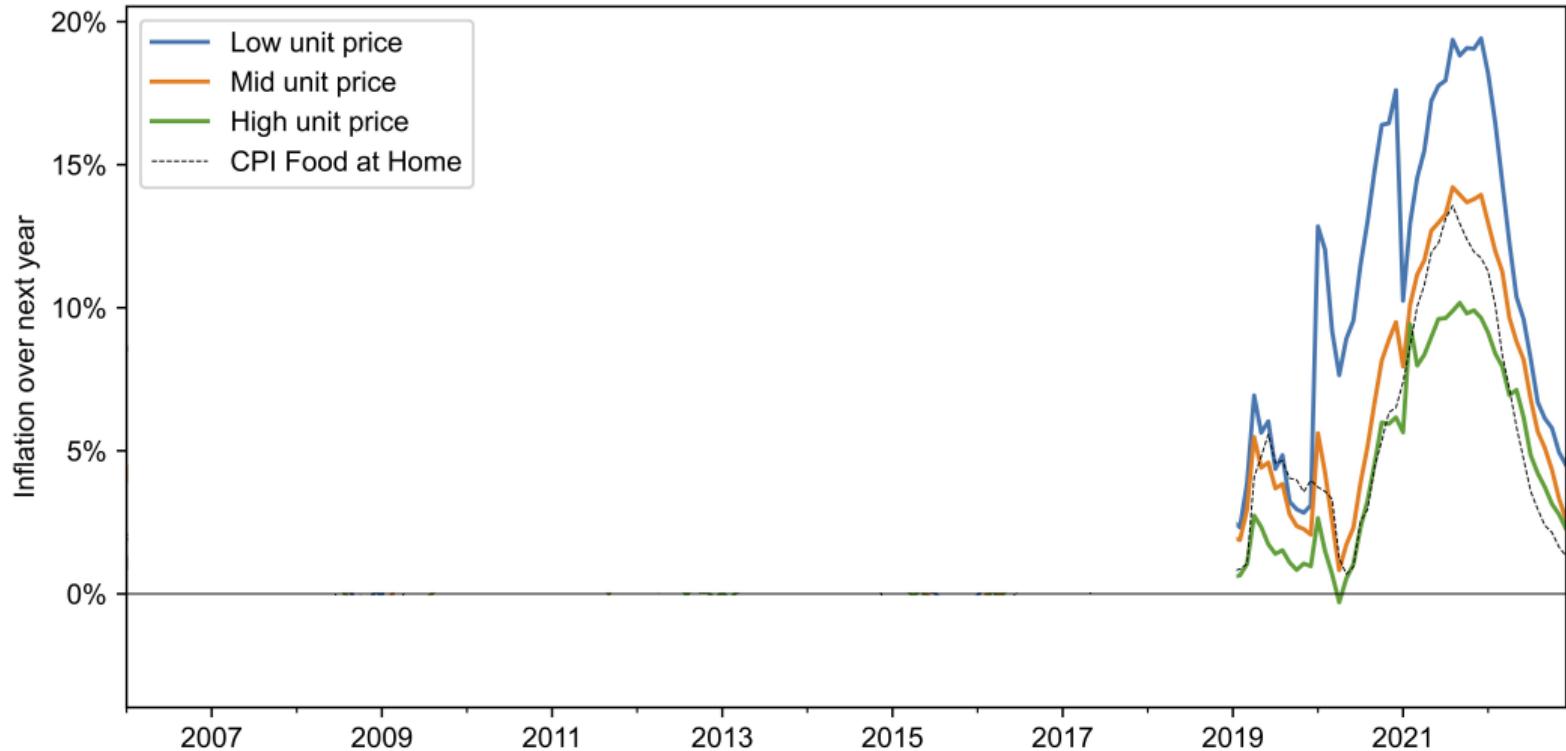


CPI series	Price growth, Jan '19–24 (pp)		
	Overall	Excl. size changes	Shrink contr.
Food at home	26.37	25.68	0.69
Household paper products	35.30	31.22	4.07
Candy and chewing gum	32.20	29.59	2.61
Snacks	23.65	21.15	2.50
Cleaning products	24.22	22.25	1.97
Ice cream & related	22.59	20.68	1.91
Coffee	22.04	20.26	1.78
Sugar & substitutes	43.22	41.58	1.64

Source: BLS R-CPI-SC research series (following McNair, 2023).

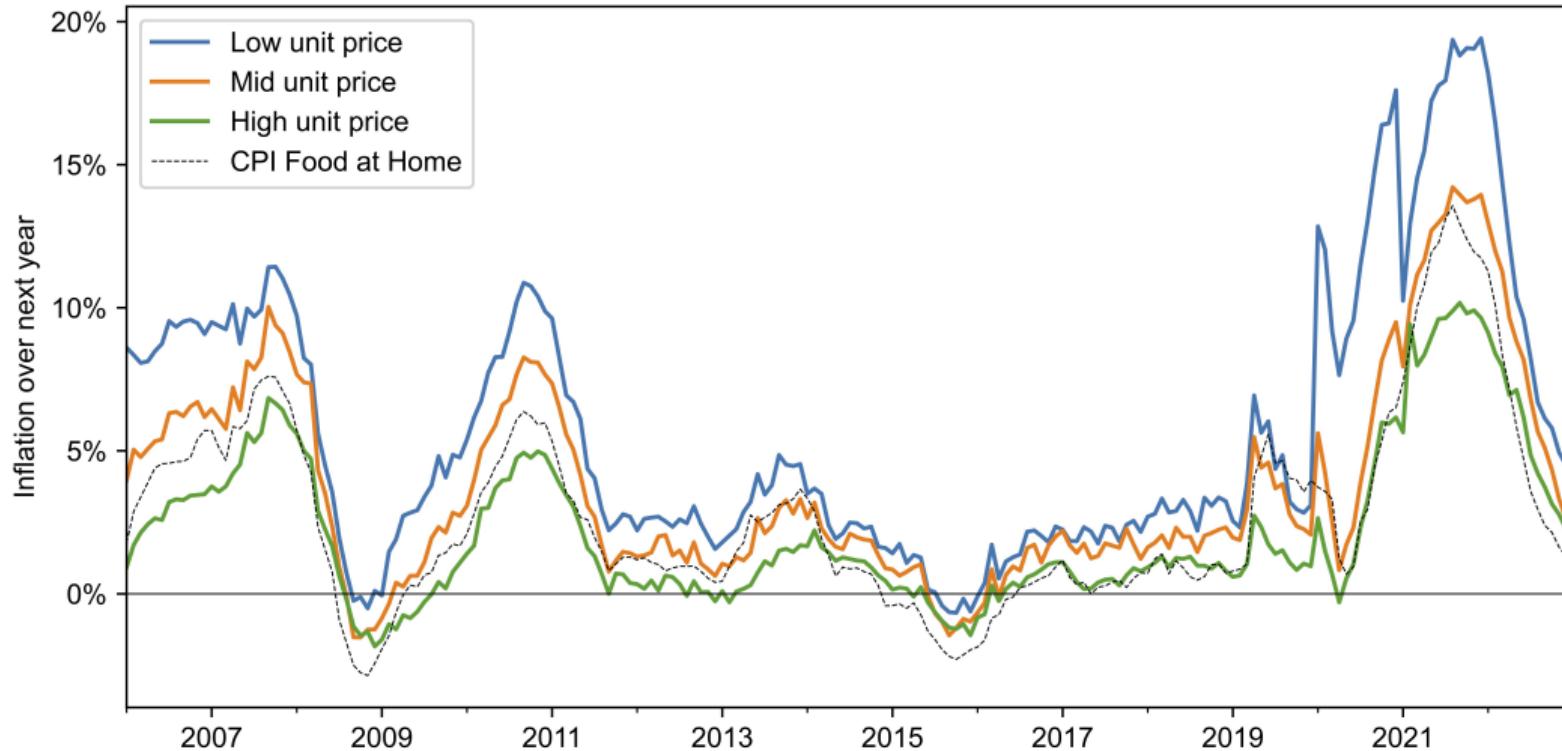
## 2. Cheapflation

- Much higher inflation for low-priced products!

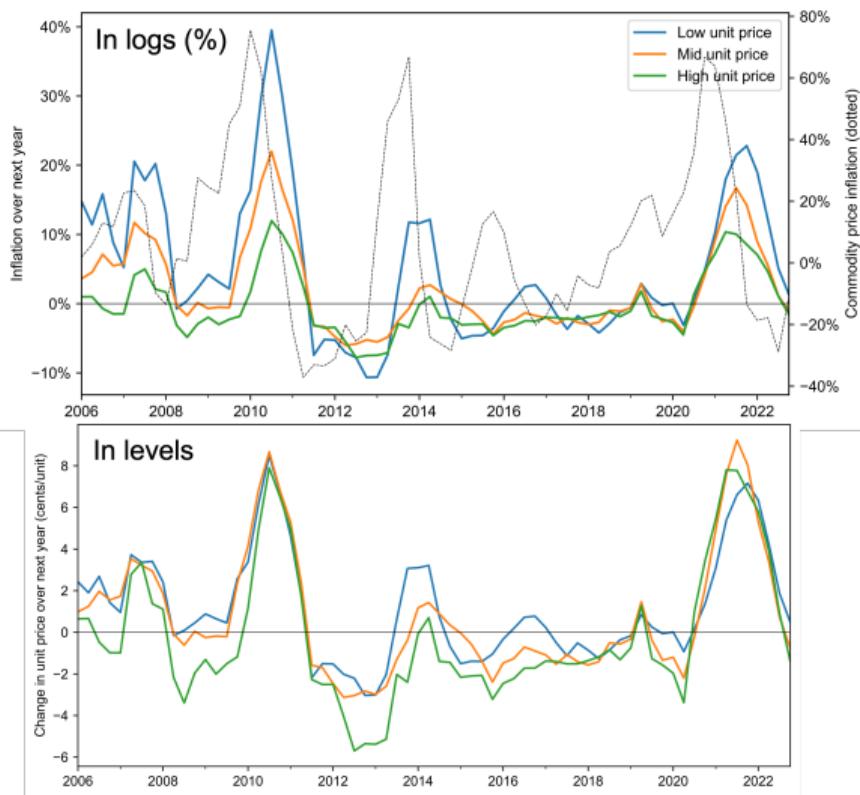


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- Much higher inflation for low-priced products! ...But this is not special to 2021–2023.



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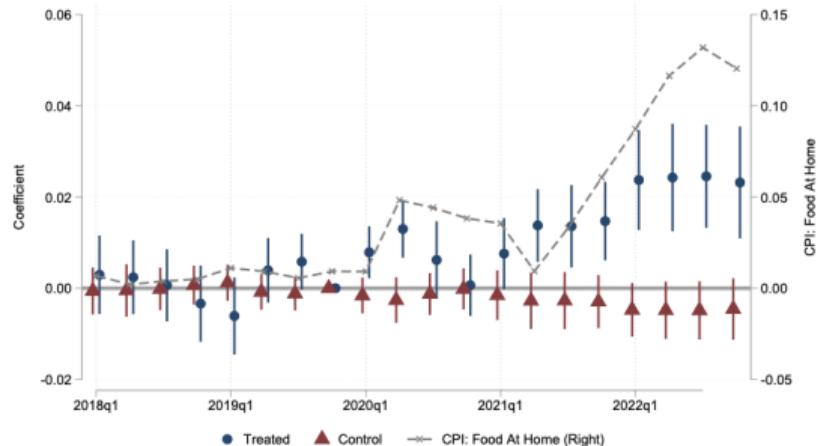
- When upstream costs increase, firms pass through costs in levels.
- ⇒ Higher inflation (in %) for cheap products.
- Accounting for this, no excess cheapflation in 2021–2023.

Source: Sangani (2024), using NielsenIQ data.

## 2. Cheapflation

Figure 4: MFMP During 21/22 Inflation Surge, Public and Private Firms

The figure shows the time series dynamics of MFMP of public firms and their matched peers around 21/22 inflation surge. we plot the average MFMP of the treated and control firms after removing the cohort-by-date and cohort-by-firm-module fixed effects. The gray dashed line plots CPI: Food at Home on the right axis. The figure shows the 90% confidence interval bands.



- Aside: Can lead to mechanical changes in “relative price” alongside inflation.

## Summary

- The role of greedflation is one of the big questions from the 2021–2023 inflation.
- Chen, Salomao, Sharma, and Wang ambitiously tackle this question through the lens of manager incentives.
  - Change in manager incentives changes “propensity to gouge.”
- Public firms’ prices increased relative to others from 2021–2023.
- How exactly do firms “greedflate”?
  - Some ways that greedy corporations could increase prices (shrinkflation, cheapflation) do not indicate unusual behavior.
  - Exciting line of research!