IlLUminate Blog Transcript: Ahmed Rahman on Greedflation

Recorded February 8, 2024. Listen to it here.

ANNOUNCER: 00:02	[music] This podcast is brought to you by ilLUminate, the Lehigh Business blog. To learn more, please visit us at business.lehigh.edu/news.
JACK CROFT: 00:13	Welcome. I'm Jack Croft, host of the ilLUminate podcast for Lehigh University's College of Business. Today is February 8th, 2024, and we're talking with Ahmed Rahman about greedflation, a term that has been hotly debated among economists, policymakers, and the news media in recent months. Dr. Rahman is an associate professor of economics in Lehigh's College of Business. He holds the Charlotte W. & Robert L. Brown III '78 Summer Research Fellowship and also is program director for the Lehigh Business PhD in Business and Economics program. In addition, Ahmed is a research fellow at the Institute of Labor Economics, a nonprofit research institute and research network headquartered in Bonn, Germany. Welcome back to the ilLUminate podcast, Ahmed.
AHMED RAHMAN: 01:05	Thanks, Jack. It's always great to be here, and really looking forward to our conversation.
CROFT: 01:09	Greedflation is a relatively new portmanteau, combining greed and inflation, that has crept into economic discussions over the past couple of years. What does it actually mean?
RAHMAN: 01:22	Yeah. So it's a new theory, in a nutshell. And it's not surprising that there would be new theories that emerge after 2021 and 2022 since so many macroeconomists were so terribly wrong about the possibility of inflationary pressures building up in the economy. And then economists were also wrong about how relatively easy, I guess, from a historical perspective, the inflation went down. And so since macro people have been so wrong on so many fronts, it seems inevitable there would be a variety of new thoughts and theories about what are the underlying causes of inflation. And so we have our new theory, I think, which is sort of, yeah, colorfully called greedflation. It's called different things, but it really refers to an idea-- it's really one of two ideas. I would say the first of these ideas is kind of on the frivolous side, not that serious, and the second one is a little bit more of a real serious economic theory that we can grapple with and think about.
RAHMAN: 02:33	The frivolous version of this is that corporations really just-- they became greedy. They became rapacious when it came to pricing. And in the face of extraordinary macroeconomic chaos, they ultimately took advantage of the American consumer, right? They had greater market concentration, so that kind of control allowed them to raise prices far beyond what one might say is a reasonable level. And moreover, they kind of lied to us. These corporations misled the reasons for these price increases suggesting possibly that, well, they had no choice, right? Sometimes greedflation is called excuseflation. Doesn't exactly roll off the tongue, but OK, I get it. Yeah, these companies are actually making these wild claims of needing to raise prices, and we as the consumers are essentially kind of collectively duped. So that's a definite version of greedflation that resonates. It's politically charged. It definitely calls for a different kind of action, maybe against corporations, maybe some punitive responses here. But

I would say it's a little bit more of the-- as I say, more of a frivolous version that doesn't necessarily really hold a lot of backing, either theoretically or empirically.

CROFT: 04:00

Yeah, it's a term that is usually credited to an economist at the University of Massachusetts Amherst, Isabella Weber, coining the term greedflation. And it was, as you, I think, kind of implied, originally met with a good deal of skepticism in economic circles.

RAHMAN: 04:22

Oh yeah. And many skeptics still.

CROFT: 04:25

Yes. And for example, a headline in The Economist last summer read, "Greedflation is a nonsense idea." Has there been a reconsideration of the role of greedflation, though, in rising prices lately among economists, policymakers, and news media covering business?

RAHMAN: 04:45

Yeah, among certain economists, no. With many economists or many policymakers, however, there is at least some consideration of the things that, as you mentioned, Isabella Weber is talking about. So this is what I'm saying the more-- the nonfrivolous version is going to be Isabella's work. And so really, where this comes from? Isabella Weber and Evan Wasner. They wrote a paper not too long ago. The paper's called Sellers' Inflation, Profits and Conflict: Why Can Large Firms Hike Prices in an Emergency? And so that's a pretty interesting title. It has a lot of specific aspects to it. And this is my simplified version of it, but their story goes something like this: During ordinary times, large companies simply can't-- they're very reluctant to raise prices unilaterally. And it's because even in concentrated sectors where there's a lot of pricing power, there's still this competition that persists. So mathematically, you can demonstrate it doesn't take a huge amount of competitive pressure to keep companies in line and not jack up their price because, ultimately, if they do and their competitors do not, it's risking losing market share. So the nature of competition-- even if it's not perfect competition, some degree of competition keeps these companies in check. Now, what Isabella and Evan's work is actually pointing out to, this kind of breaks down potentially in the context of supply shocks. So as we might have remembered, in 2020/2021, we had these bottlenecks in the supply chain, and that's yielding all kinds of shortages of inputs. And the threat of competition actually stops to restrain price gouging because all these companies are sort of facing the same supply crunch, right? So this leads a company to actually raise their prices, and there's no real fear that they're going to lose market share. So there's no new competition, ultimately, that's keeping the company in check.

RAHMAN: 06:46

And then the final piece of this version of greedflation is that this becomes particularly important in concentrated industries and upstream industries. Upstream sectors would be those companies-- they produce goods that are critical to the functioning of other businesses. This could be energy companies, chip makers, these sorts of firms. So when they exploit the bottlenecks, right, and they increase their profit margins, they're forcing these downstream businesses to increase their prices as well. And that's the ripple effect that kind of filters through the economy. And that's where they claim that it is profit margins themselves that are contributing to the overall price increases in the economy. That's, I think, their discussion, in a-- so it's not about a sudden flare-up of greed from companies, but it is coming from the profit motivation of companies. And they're able to exploit the specifics of bottlenecks, coupled with consumers being maybe a little bit confused about what's going on. And so they're really able to pass off any kind of cost increase over with really big price increases for the rest of us.

CROFT: 07:59 I think, at least within the public debate on the issue, there seems to be a very clear and simple argument that goes something like this, which is that the excessive corporate profits are a prime driver of inflation. And the proof is, profits increased by far more than inflation during the pandemic and the period immediately after. For example, in 2021 inflation rose by 7% in the U.S. while corporate profits soared by 22.6%, more than three times the inflation rate. So is the connection between corporate profits and rising prices really that simple and clear-cut?

RAHMAN: 08:48 Yeah, if only. Right? I think these numbers are definitely compelling, and it points to a story that seems to suggest that corporate profitability is definitely related to inflation. But again, correlation and causation are not the same thing, as I often try to teach consistently to my students. Now, there are studies that I've seen that actually have tried to make this connection. The Economic Policy Institute, for example, recently suggested that something like 53 or 54 percent of the inflation that we've seen in the recent couple of years was driven by this corporate profitability. Whereas, before, profit margins might only contribute to sort of a small part of overall inflation, these studies seem to suggest that something might be different. I hasten to add that, of course, inflation has been pretty moderate for many decades.

RAHMAN: 09:43 And so one thing that I would caution anyone when making this connection between profitability and inflation is that we really don't have very many episodes that we can look at where they have double-digit inflation. That's a good thing, right? We don't want to have 11 or 12 percent inflation. When we had it in the ’70s, this relationship between price growth and profit margins wasn't really carefully studied that much. Now, this is sort of a new opportunity for us to look at this relationship. It begs the question of whether this has always been the case in the past. It certainly, though, looks like it's the case today, but I would hasten once again to say there is a difference between cause and effect. In America, okay, the profit margins of-- yeah, many of these nonfinancial corporations, they surged. The question is, did they surge because of the fiscal stimulus that came from the pandemic, right? Which, remember, amounted to something like 25% of the GDP. That infusion of stimulus and cash in the economy, which, if you remember, the Federal Reserve didn't really offset with interest rates until much, much later, kind of set off this consumer spending. And so you couple that with the supply chain problems, it's not like this is incompatible with high profitability, right? And the real question for us is, is it the profitability that's driving the inflation or rather the price increases that's giving the companies an opportunity to raise prices, but that's not the fuel that's causing the underlying inflation? It could very well be that the underlying inflation is coming from that excess spending that came from all that stimulus, and the companies are reaping the rewards of that, but they are not the prime culprit.

CROFT: 11:28 I'm wondering, what are the main factors that have contributed to inflation over the past four years? Obviously, the pandemic was a huge factor in all of this. But what are some of the other things that you think have played into it?

RAHMAN: 11:46 Yes. I actually combine the pandemic, this one P, into four Ps of inflation. I like to talk about this, especially when I do the Lehigh back-to-school lecture. So I call it the four Ps of inflation: Putin, the people, the president, or Powell. These are the culprits that I point to. And of course, they're stand-ins for these big macro ideas. Putin is a supply chain problem. That was the limited supply. The people is like a price-wage expectations problem. That's a standard inflation story where workers demand higher pay, firms acquiesce and give the higher pay, but then they pass it over to higher prices, and then it fuels more higher pay, and so on. So is it the people? The president, of course, stands for fiscal policy. Was it all the spending coming out of the White House and Congress that creates the fuel for inflation fires? And then finally [Jerome] Powell who's, of course, head of the Federal Reserve. Is it the monetary policy? Is it the printing of too much money that caused it? And so all these are more traditional factors that relate to the question that you mentioned. These are the things that most macroeconomists have focused on over the last few years. I guess possibly now I have to add a fifth P. That fifth P is profit, right? It could be that now it's the profitability, and that's a new thing. And it's exciting because now, yes, we have a new way potentially of thinking about inflationary dynamics and what to do about it. So we're going to have a lot of disagreement and a lot of debate, but it's always exciting when these new theories kind of pop up and we let the scientific world of macroeconomics figure out what are the benefits of this new idea, what are some of the downfalls of this idea.

CROFT: 13:36

Now, from the research you've seen, then, how much do you believe corporate profits actually contribute to inflation at this point? You had mentioned the one study that said it was just over half.

RAHMAN: 13:49

Yes. Yes. And there's been a couple of other pretty prominent studies, one done by the Kansas City Federal Reserve, another done by the European Central Bank. And they both kind of echo this idea of inflation being driven by a little bit of a-- a causal claim without necessarily really getting into the ability to tease that out. They're still saying something pretty provocative, which is that it's corporate profitability that really drove this inflation through this upstream process that I had mentioned earlier. There are a few things that don't look really great about the greedflation hypothesis, even that serious version. So one of them - and this is also documented by the Kansas City Fed - is that oftentimes companies, they will do what's called anticipatory price setting. And that's where companies will-- they're expecting higher costs in the future, and so they actually raise their prices today in that anticipation of dealing with their margins which they predict in the future will be squeezed. And actually, it turns out that every recession going back to the end of World War II seems to have this pattern of firms in a recession-- the input costs are sort of artificially depressed. And so firms know that, and they're going to raise profits in the short run in anticipation of squeezed profits later on. And I'm not saying that that is going to be the primary thing that's going on here, but one has to look today and say that, "You know what, profitability definitely has shrunk relative to what we were talking about in 2022 and 2023." Now companies are making quite a bit of money, but it's definitely going in the direction that history would suggest. So that's one thing that actually kind of questions our thinking about greedflation.

RAHMAN: 15:37

The other, maybe the more important, is that, look, even in highly concentrated sectors, profit-maximizing firms, they can only raise prices if consumers let them raise prices. And a lot of economists would say, "Maybe consumers let them raise prices because they were flush with cash. And they were flush with cash because the government policies made them flush with cash," right? That's sort of an argument that's more traditional-minded macroeconomists and inflation side. I think the greedflation people would say, "Well, yes, they can only raise prices because consumers let them, but this is extraordinary times and consumers were-- either they were kind of lied to or misled or they themselves don't really know what's going on, and so they're willing to give the companies the benefit of the doubt and pay for these higher inflated prices for all these things." Unclear, but again, this is the back and forth that we're looking at when it comes to, "Is it really this profitability that's driving it?" So there's a couple of things that actually point against the greedflation hypothesis in its current iteration.

CROFT: 16:44

Kind of moving from the macro to the micro, although I guess it's not really micro, just taking one sector as an example because I think that's driving particularly the public debate over it. And I know I've been hearing this for months, that-- I remember my landscaper-- we were having a conversation just a few months ago, and he said, "This inflation, it's really getting bad. My wife went to Lansdale Meats, and a loaf of bread was over $5. Something's got to be done." And the grocery shopping is driving a lot of the discussion, not just with the public but, at this point, even with policymakers. And part of the thing is that, even though inflation has slowed in the U.S., people haven't seen the prices come back down, and in fact, in some cases, they're still growing. And that's especially true in grocery shopping and actually, quite literally, is a meat and potatoes issue, along with bread, baby food, sugar, citrus, fruits, some other things. So again, what are the main factors involved in the higher prices, specifically within grocery and food, and how much do we blame corporate greed for that?

RAHMAN: 18:15

Yeah, yeah, very important for this debate and, I think, 100% correct. I'm sure many of us have read the [U.S. Sen.] Bob Casey report, right, that actually kind of lays out that particular version of what greedflation means to the consumers of Pennsylvania. And he makes the case pretty clear. Frosted Flakes is up 14%. Chicken is up 20%. Dish soap is up 12%. He says, "Do you want to see a movie? Well, all the appurtenances at movies are also-- popcorn's up 17%. You want to get a soda? That's 11% increase." Just streaming the movie from Disney is 27% more. This is definitely resonating with the American populace. There is something to be said with this kind of inflation, which-- again, we might call this a price-price inflation. It's not a wage-price inflation. A wage-price inflation is where the workers are bidding up the wages and then firms have to bid up the price. In some respects, wage-price inflation protects the worker because they are keeping up with inflation with their increased-- they're actually causing the inflation as they raise their wages, but at least they're keeping pace with inflation. And this price-price inflation, where it's the pricing that companies are increasing without even maybe increasing volume, is leaving workers much more vulnerable.

RAHMAN: 19:40

So in that respect, I fully agree with the Casey report, that it's actually creating a situation where individuals are looking like they're very vulnerable, and in fact, corporate profitability is part of that. It doesn't help that we have all these earnings reports by these companies that actually explicitly state what they are doing. I mean, I think PepsiCo recently had said, "Yeah, we're increasing the price, and we're seeing the customers come along with us" - quote-unquote, "come along with us" - meaning, "They are willing to absorb these price increases, and we can actually sort of get away with it." And so that's sort of what we're hearing in these earnings reports. Again, something that we never saw in the 1970s because we didn't pay attention to those things too carefully. So along with this, there is something to be said-- I worry, of course, about what the potential solutions are. As I say, I think the more frivolous version of greedflation comes up often, and it becomes, "Well, we can point the finger at particular companies, and they're the ones that actually should bear the burden." And it resonates with lots of people, especially that don't like the way we fight inflation in the traditional sense. If we can pinpoint specific egregious behavior - let's say Pepsi Company; let's say Disney; let's say these companies that clearly have these inflated profit margins - then maybe we can fight inflation more carefully, not with the big broad brush of the higher interest rate policy. I have my suspicions, but that's what's being discussed these days.

CROFT: 21:22 Now, what are some of the other-- let's take for the premise here that greedflation is in fact a contributor to some extent, and according to some of the studies, to a large extent if it's half over the last few years. So what are some of the potential solutions that you think might make sense?

RAHMAN: 21:46 Yeah. So again, this is where the debate is very interesting. A new theory calls for potential new solutions. I think the underlying cause still remains unclear. At the end of the day, greedflation as a theory is not really a theory about the causal impacts of inflation. I think it's important for people to know that. It's much better as a theory of who are the benefactors or losers from inflation. I think, as a theory, greedflation really helps us understand that. As I said, the normal typical wage-price spiral type of inflation, we might not concern ourselves too much with the welfare of the American worker and consumer because they are in some ways protected, but this kind of price-price inflation is far worse for people. The solutions, however, I worry focusing on targeting specific companies that seem to be the culprit when, in fact, it's not so much the companies that are the culprits. It's the underlying demand that has been fueled by a series of fiscal and monetary policy decisions that happened in the past.

RAHMAN: 22:52 My perspective is, rather than be punitive - whether it's sort of windfall profit taxes, which has been thrown around, whether it's outright pricing caps, which have been thrown around - we have to acknowledge that even right now-- Europe, we've seen a series of price caps that is a response to their inflation. The United Kingdom is talking about capping prices of certain groceries right now. And indeed, people in this country, including Senator Casey, is talking about price caps of this nature right here at home. We in the macro profession, or at least many of us, might really, really not want that world to happen because a little bit of history will tell us that these price fixes often are far worse than the disease, and they make shortages run rampant. Brazil tried this in 1986. Their inflation was going up through the roof, so they tried to simply say, "You know what, companies, you're not allowed to raise prices anymore." And that was quite a disaster. It resulted in all kinds of crazy shortages, and then once they released the prices, of course, hyperinflation ensued. So we do want to learn a little bit of the history of, I guess, easy fixes. And one thing about greedflation is that I think it points to a potential of easier fixes that are maybe a little bit red herrings. They're not really quite the direction we would want.

CROFT: 24:16 And now, the other side of this, obviously, is the-- you talked about kind of the benefactors and those who have been on the losing side. This discussion brings us to the consumer. So in the face of these rising prices, and again, to whatever extent greedflation is a factor in this, what are some of the things that consumers do to improve their lot in this?

RAHMAN: 24:48 Yeah, I think one thing-- and this is a frustrating element of these sort of elevated prices that's a function of all the inflation that we've experienced over the last few years. These prices, for the most part, are probably not going to be much lower than what we are seeing now. And the reason is, while we hate inflation, macro people really despise deflation. Deflation is even more destabilizing than inflation because when prices go down, they induce consumers to not buy anything, firms can't sell their wares and therefore have to [inaudible] their people, and then you end up with this potential spiraling of lower and lower prices. Debt becomes extremely hard to manage as the debt value grows and grows for debtors around the country. So as a result, deflation is something that we avoid. But at the same time, isn't that what consumers kind of want? We want these prices to adjust back down to what they were before. And I think it's important for the American consumer to sort of brace themselves and say, "That's probably not going to happen." You see prices going down here and there - maybe for eggs, maybe for chicken, maybe for certain products - but aggregatively, that's not something that we can expect.

RAHMAN: 26:09

So that being said, what can one do? Unfortunately, it's usually the standard idea. Inflation, you can't really-- you can shift your spending. You have to be much more cost-conscious, but that cost-consciousness can only go so far because inflation, by definition, is a price increase of everything. So it's not like you can shy away from everything. You have to buy certain things. But obviously, budgeting is going to be more important in this case. Relative price differences are going to be more important in this case. Having a food plan, for example, just being more careful. And then in terms of trying to protect your savings. We have to acknowledge that inflation eats away at our nest eggs, right? So looking for higher-yield savings accounts, for example, or investing in TIPS, these Treasury securities that are actually protected from inflation. These are good ideas. No one really wants to think about this too much, obviously, but these are important considerations for households, again, as I say, in a context where we really can't expect prices to sort of go back to the old days. I know it's a political season. We like to think about back in the day when America was, whatever, great. We try to find that time when bread costs 2 bucks, when milk costs 99 cents, and so on, right? And we should all think of that as truly a time of the past, and we need to adjust to what our spending power is in the year 2024, which, as it turns out, is not that great. And we need to be a little more careful about our spending in that elevated price environment.

CROFT: 27:55

Now we're running short on time, but I would like to give you one last chance if there's anything we haven't discussed so far. We've covered a lot of ground, but if there's anything important that you think the listeners should know about greedflation, inflation. We didn't even talk about shrinkflation and all the other-- [laughter]

RAHMAN: 28:19

That's right. Sellers' inflation is less sort of exciting. We talked a little bit about it. You have a new way of thinking about inflation, and yet it's also at the same time a little bit dangerous. It's not like we haven't been here before, when prices are going up and up and up or down and down and down. If there's just instability, we have different ways of thinking about how to solve it. And it seems reasonable to look at who seem to be the big beneficiaries of inflation, which are the corporations. And these corporations are actually telling us that they're benefiting from inflation because their earnings reports-- they have it right there. But I would caution the American public-- I would caution us to vilify companies for doing what they are actually intended and designed to do in the first place, which is to make money for their shareholders, provide quality products for their customers. And when they do that, we have to expect that, during especially weird times, there's going to be profitability that goes up through the roof. There might also just as easily be profits that collapse, and you end up with a great number of bankruptcies, and so on. These are the vicissitudes of the economy. And so as much as people who like greedflation like to think about the solution as, "If we just pinpoint a couple of these culprits - its Amazon, or it's Disney, or it's Apple - and we just tell them, 'No, no, no, you cannot raise prices beyond a certain threshold,' then that'll be the solution," I think that's far too simple, and I think it causes more problems for the macro system than it solves. And yet, I think we should listen and hear them out because there is something to be said about this round of inflation that has been so detrimental. But I think we should keep an open mind on all of this. That would be what I would advocate to everybody.

CROFT: 30:13 On that note, I'd just like to say thanks, Ahmed, for being with us again on ilLUminate.

RAHMAN: 30:19 You're welcome, Jack. Thanks a lot.

CROFT: 30:21 Ahmed's research areas include economic growth, economic history, immigration, and the economics of education. Some of his current research focuses on the effects of peers and teachers on college student performance, the impacts of different experiences in military service on private-sector employment, and the wage and employment effects of immigration on native workers. This podcast is brought to you by ilLUminate, the Lehigh Business blog. To hear more podcasts featuring Lehigh Business thought leaders, please visit us at business.lehigh.edu/news. You'll also find links there to follow us on your favorite social media platforms. This is Jack Croft, host of the ilLUminate podcast. Thanks for listening.