United States Senate Committee on Banking, Housing, and Urban Affairs

Hearing on "Higher Prices: How Shrinkflation and Technology are Hurting Consumers' Finances"

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Chairman Brown, Ranking Member Scott, and honorable members of the Committee, thank you for inviting me to speak on the pressing issues surrounding how corporate pricing strategies are impacting prices, and their implications for consumer finances.

In my testimony I will make three points:
1. Inflation is being driven, in part, by corporate profiteering related to firms' price-setting power.
2. Corporate profiteering is harming consumers, workers, and other businesses.
3. Government has tools that can restrict corporate profiteering and protect consumers and small businesses.

First, there is evidence that large corporations are engaging in pricing strategies that are contributing to elevated prices. Research conducted by my colleagues and I at the Roosevelt Institute has found that a recent sharp rise in markups by large corporations is contributing to inflation.[1] Markups are the difference between the prices consumers pay for goods or services and how much it costs to make or provide them. Markups are low in competitive markets but as corporations have accumulated significant market power over the years, they have been able to increase prices without sacrificing profit. Our research finds average markups grew from 48 percent above cost in 2014 to 69 percent above cost in 2023 and that this growth is being driven by a few large corporations.[2]

For consumers, markups can take several forms through various pricing strategies employed by corporations:

- **Standard Retail Markup**: This is the most straightforward markup, where sellers add a percentage to the cost of goods and services to generate profit.
- **Shrinkflation**: Reducing the quantity or size of a product while maintaining or increasing the price.

[1] Konczal, Mike and Niko Lusiani. 2022. "Prices, Profits, and Power: An Analysis of 2021 Firm-Level Markups." Roosevelt Institute, June 21, 2022. https://rooseveltinstitute.org/publications/prices-profits-and-power/.
[2] Bustamante, Alí R. and Ira Regmi. 2024. "Fast-Food Industry Profiteering: Why California Businesses Can Absorb a Higher Minimum Wage." Roosevelt Institute, March 28, 2024. https://rooseveltinstitute.org/publications/fast-food-industry-profiteering/

- **Dynamic Pricing**: A method of price discrimination whereby prices adjust in real-time using pricing algorithms and sophisticated consumer data, often with new artificial intelligence (AI) methods.
- **Decoy Pricing**: Pricing structures where firms introduce a third, less attractive option to lead consumers to choose a more expensive option than they originally might have.
- **Bundling**: Bundling products together to sell them at a price that seems to offer a savings compared to buying each item individually but that often includes a markup.

Markups, and the sophisticated pricing strategies that are driving them, are on the rise because of large corporations' outsized pricing power. Research finds that smaller firms in less consolidated industries have not driven explosive markup growth.[3]

Take the fast-food industry for example: my recent research of markups finds that the average markup in the fast-food industry grew by 14.7 percent during the past decade.[4] When analyzing markups at the 10 largest fast-food firms in 2023 we found that they were the highest at Wendy's, McDonald's, and Restaurant Brands International (the parent company of Burger King and Popeyes). At these firms, prices were between 80 and 91 percent above companies' marginal costs. These large companies are charging consumers above and beyond what is necessary for typical profit margins.

Second, there is ample evidence that markups–and corporate profiteering in general–by large corporations are harming consumers, workers, and small businesses.

Consumer surplus, how economists measure the social economic benefits of consumption, would have been 14 percent higher in 2019 if markups had remained stable at 2006 levels, and 50 percent higher if firms passed along the reductions in their costs over that period to consumers.[5] This hits low-income consumers the hardest, as their disposable income is stretched even thinner, forcing them to make difficult decisions about the basic necessities and bills they need to cover.

Workers are also being squeezed: research shows that increases in markups lead to a decline in wages of approximately 12 percent, because markups lead to a reduction in the aggregate demand for labor.[6] The harmful effect of markups on workers is also visible in the declining

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[3] De Loecker, Jan, Jan Eeckhout, and Gabriel Unger. 2020. "The Rise of Market Power and the Macroeconomic Implications." *The Quarterly Journal of Economics* 135 (2): 561–644.

[4] Bustamante, Alí R. and Ira Regmi. 2024. "Fast-Food Industry Profiteering: Why California Businesses Can Absorb a Higher Minimum Wage." Roosevelt Institute, March 28, 2024. https://rooseveltinstitute.org/publications/fast-food-industry-profiteering/

[5] Döpper, Hendrik, Alexander MacKay, Nathan Miller, and Joel Stiebale. 2022. "Rising Markups and the Role of Consumer Preferences." 3939126. Rochester, NY: Social Science Research Network.

[6] Deb, Shubhdeep, Jan Eeckhout, Aseem Patel, and Lawrence Warren. 2022. "Market Power and Wage Inequality." Institute for Fiscal Studies, Working paper 22/40. https://ifs.org.uk/publications/market-power-and-wage-inequality

share of income going to workers.[7] Rather than rewarding workers who drive productivity in the first place, these large corporations driving growth in markups are the same ones returning higher profits from markups to wealthy shareholders via stock buybacks and dividends.[8]

Furthermore, markups reflect a "winner takes most" economic environment where large corporations with price-setting power also have the capability to reduce competition by creating barriers for new firms to enter the market, crowd out smaller firms, and squeeze supplier margins in order to protect and expand their market share.[9]

Lastly, I'd like to discuss the myriad of available government tools that can restrict corporate profiteering and protect consumers, workers, and small businesses:

- We need to **enforce and strengthen antitrust laws** to prevent monopolistic practices and ensure competitive markets, particularly in industries where a few companies control significant market share, leading to higher markups.
- Policymakers can move to **create guidelines and restrictions around the use of dynamic and personalized pricing** to prevent unfair and deceptive practices by requiring businesses to fully disclose the pricing structure of their products and services. This would disincentivize corporations from employing these predatory pricing practices.
- To improve fairness and transparency in pricing, administrative agencies like the Consumer Financial Protection Bureau can mandate **clearer disclosure of pricing components** and service fees and **enforce rules against deceptive pricing practices** or hidden fees. This is particularly impactful in sectors prone to high markups, such as financial services and healthcare.

There are great economic benefits to be gained by reining in markups and unfair corporate pricing strategies, including lower prices in the short term and a more competitive economic environment for businesses and workers in the medium and long term. Yet, inaction from both regulators and legislators will enable corporate profiteering that continues to elevate prices, harm consumers, and squeeze small businesses.

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[7] Autor, David, David Dorn, Lawrence F. Katz, Christina Patterson, and John Van Reenen. 2020. "The Fall of the Labor Share and the Rise of Superstar Firms." *The Quarterly Journal of Economics* 135 (2): 645-709.
[8] Palladino, Lenore, and William Lazonick. 2021. "Regulating Stock Buybacks: The $6.3 Trillion Question." Roosevelt Institute, Working paper, May 10, 2021. https://rooseveltinstitute.org/publications/regulating-stock-buybacks-the-6-3-trillion-question/.
[9] Autor, David, David Dorn, Lawrence F. Katz, Christina Patterson, and John Van Reenen. 2020. "The Fall of the Labor Share and the Rise of Superstar Firms." *The Quarterly Journal of Economics* 135 (2): 645-709.