

Office for National Statistics (ed.), “Households Inflation and income inequality in the UK”, *Economic & Labour Market Review* (October 2020): 43-56.

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Income inequality is one the rise in nearly all countries around the globe. The UK, where wealth has been distributed much less equally than in most other western European nations for decades, is struggling with a rising Gini coefficient. Standing at 35% in 2020, it is not only higher than many of its European counterparts such as Slovenia (24.4%), Belgium (27.2%), The Netherlands (28.1%), France and Germany (32.3% each), but also surpasses countries like Thailand, Tunisia, Canada and Australia (Statista, 2021).

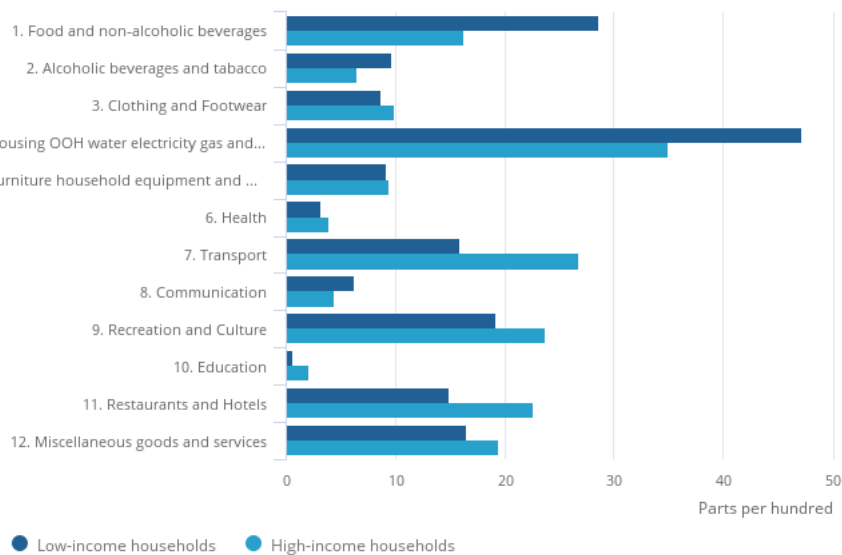
The UK’s income inequality of 36.3%, as measured by the Office for National Statistics (2021) for the financial year ending 2020, was the highest reported the decade between 2010 and 2020, highlighting a widening gap between the wealthiest social groups and the rest of the British population. In a mere 10 years (from 2010 to 2020), the income share of the richest one percent of the population grew to 8.3 % (up from 7%) (ONS, 2021). As the period for FYE ended just before the Covid-19 pandemic started, the projected growth in inequality among the British population has not yet been accounted for. Yet, considering that a plethora of studies have highlighted that pandemics raise income inequality, the next edition of the ONS’ study on income inequality might reveal a considerably higher Gini coefficient, which could last well beyond the end of the Covid-19 pandemic.

Using Household Costs Indices (HCIs) as a deflator of income, the Office of National Statistics impressively highlights that while “nominal income increased 45.9% and 43.4% for low- and high-income households, respectively” between 2005 and 2018, inflation made these gains for low-income households negligible. Due to household inflation, the rise in real income for the poorer households was a mere 4.3%, whereas real income for high-income households increased by 7.7% over the same period. This difference of 3.4 percentage points between the low- and the high-income households is significant, showing that despite wage increases, low-income households have benefitted substantially less from their higher nominal income than their richer counterparts due to inflation.

Why is this the case? First of all, it is because households with higher income spend a smaller share of their income household consumer goods than their poorer counterparts. However, this alone does not explain why inflation has a different impact on different household groups, such as low- and high-income households, households with children, or retired households. The reviewed article ‘Household inflation and income inequality in the UK’ (2020) nicely shows that different household groups (e.g. households with/without children, with/without retirees) experience different levels of inflation due to their different consumption patterns. A similar difference also exists for low-income and high-income households (defined as those within the second income decile and the ninth income decile, respectively). While a large share of expenditure in low-income households is for daily necessities such as food, drinks (both alcoholic and non-alcoholic), tobacco and housing, high-income households have a higher share of expenditure for education, transportation, restaurant meals and hotel stays. The table below visualises the different spending patterns:

Figure 1: Housing costs are a significant expenditure for both low- and high-income households

Expenditure shares for the HCIs of low- and high-income households by COICOP division, UK, 2005 to 2019



Source: Office for National Statistics - Household Costs Indices

From: ONS (2020), p. 46.

In periods when the price increase for luxury goods surpasses that of regular household goods, high-income households are likely to experience higher inflation rates, and vice versa in case daily necessities get more expensive, as low-income households' capacity to substitute their purchases for cheaper products is limited. In addition, demand for general household goods such as food and beverages is inelastic, meaning that even if prices rise, these goods are still purchased. As a result of the different levels of expenditure among different household groups, inflation has had a different impact on the UK population. The article provides a better understanding of how different people have experienced the changing prices and costs over time. By analysing the HCIs, it reveals "how much the nominal disposable income of different household groups would need to change, in response to changing costs, to enable households to purchase the same quantity of goods and services of the same quality."

The study shows that inflation has impacted both low- and high-income households between 2005 and 2018. Different to the years of and right after the Eurozone crisis (2008-2013), the 12-months growth rate of the HCIs for both low- and high-income households follow a similar pattern and have been converging since 2014. In other words, inflation in recent years had some impacts on income inequality in the UK, but not as much as in the years 2008-2013. After a peak of the Gini coefficient (and thus inequality) in 2008, the real Gini coefficient displays a similar development as the nominal Gini coefficient, yet approximately 1 percentage point higher than the nominal Gini coefficient. This reveals that overall, inflation does have an impact on inequality, which increases with higher inflation.

What sets this survey apart from others is that it does not use the Consumer Price Index including owner occupiers' housing (CPIH) as lead measure for inflation, but instead gauges inflation based on the Household Cost Indices (HCIs). This bottom-up approach of measuring inflation analyses the experience of (subgroups of) households in face of changing prices, revealing how inflation changes their household budget. This more "democratic" weighting approach is interesting as it "assigns equal weight to each household's share of expenditure".

Methodologically, the study is as sound as one would expect from the Office for National Statistics, and the data is presented in an interesting and convincing way. Yet, the results themselves are hardly surprising, with little new knowledge gained after working through the 14 pages. The findings are as one would expect: high-income households leave a larger share of their expenditure in restaurants, for hotels and for transport than low-income households, showing that less affluent people tend to cook more at home (and thus spend a bigger portion of their income on food and non-alcoholic beverages than their rich counterparts), and have lower expenditure for air travel and expensive cars. For many people from low-income households, frequent hotel stays, dining out or going on holidays by plane is more the exception than normality. For air and railway travel, for example, the expenditure share by high-income households is twice as high (6 versus 3 parts of 1,000) as for low-income households. While the data is interesting, the results are hardly surprising, as pointed out before. In addition, also the survey's general finding that income inequality rises with inflation is not unexpected, as it has been pointed out repeatedly in academic literature. Still, it is good to see that empirical data from the UK back up previous literature, as income inequality rose when inflation rises for all years but 2011 (largely due to the impact of the financial crisis on interest rates).

While the findings of this study were not groundbreaking, it was a good read on an interesting topic, well-presented and filled with convincing data. I look forward to the next survey on this topic, as I expect the current Covid-19 pandemic to have a significant impact on income equality. As Furceri et al. (2020) have shown at the example of SARS (2003), H1N1 (2009), MERS (2012), Ebola (2014) and Zika (2016), epidemics (or pandemics) lead to a steady increase of the Gini coefficient – despite numerous policies to redistribute income more across the social groups. The study of the five pandemics reveal that the negative effects on income inequality persists even when the epidemics end. Five years after the occurrence, the Gini coefficient in the surveyed countries was still up by nearly 1.5 percent.

Given that the Covid-19 pandemic has disrupted the global economy like nothing else after WWII, with a negative impact on wealth much higher than during the financial crisis in 2008, it would be interesting to see how inflation and inequality will develop over the next years. The authors of the study project widening inequalities among the rich and the poor (with a higher share of income distributed to occupations where people can work from home), proposing that blue-collar or less paid workers might voluntarily or involuntarily reduce their scope of labour force participation due to the increased risk associated their employment. Whether this really is the case, and to what extent the gap between the rich and the poor will widen, will most likely be revealed in the ONS' next paper on income inequality and inflation. I very much look forward to this as it will likely reveal more unexpected findings than the current survey.

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