ECOSOC

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Issue Description

COMMITTEE Economic and Social Council
ISSUE The Effect of Inflation on Low-Income Families and Individuals
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Introduction

In the past decade, global inflation rates have been on a relentless climb, impacting economies and reforming financial landscapes. As central banks struggle with the complexities of price stability, the average consumer is left to navigate a world where the cost of living seems to be in a continuous ascent. Inflation stands as a formidable force, impacting the lives of individuals and families across diverse social and economic backgrounds.

People experience varying degrees of inflation based on household composition and income. It is a phenomenon that touches everyone to some extent, however, its consequences are most acutely felt by those who receive a salary lower than average at the end of each month. While inflation escalates day by day on almost every product and service, the income of individuals rarely sees a corresponding increase. Moreover, low-income households consume a larger share of their earnings than high-income families hence why they don't have much room to lessen sharp increases in their cost of living through savings..

Definition of Key Terms

Inflation - The rate of increase in prices over a given period. It happens when prices go up and the purchasing power of money goes down.

Inflation stress - Inflation causes people to experience depression or anxiety. It worries individuals because they might not be able to provide their family's basic needs.

CPI - The measure of the percentage change in the price of a basket of goods and services consumed by households.

Savings account - Saving money for a longer period; money that you don't want to spend right away.

Interest rate - Interest rate on a savings account is the amount of money a bank or a financial institution pays a depositor for holding their money with the bank..

General Overview

While the issue of inflation seems to be recognized, the repercussions are not as widely acknowledged. Concerns about financial stability are nothing new but inflation has taken hold and the cost of living spiked without the wages keeping pace. Consequently, more and more people are beginning to experience anxiety about their financial situation, a phenomenon commonly referred to as inflation stress. People experience varying inflation rates leading to different levels of inflation stress based on household composition, income, and other factors. The Census Bureau conducted a survey in the USA receiving responses from 154 000 people between April 2020 and November 14, 2022. Nearly all respondents 97% reported an increase in prices with nearly half of them (47%) expressing high levels of stress about this situation. Additionally, more than 60% expressed significant concern about future, short-term inflation. Inflation takes away your sense of security, especially for those who are living from paycheck to paycheck because their income might not be able to keep up with the increasing costs.

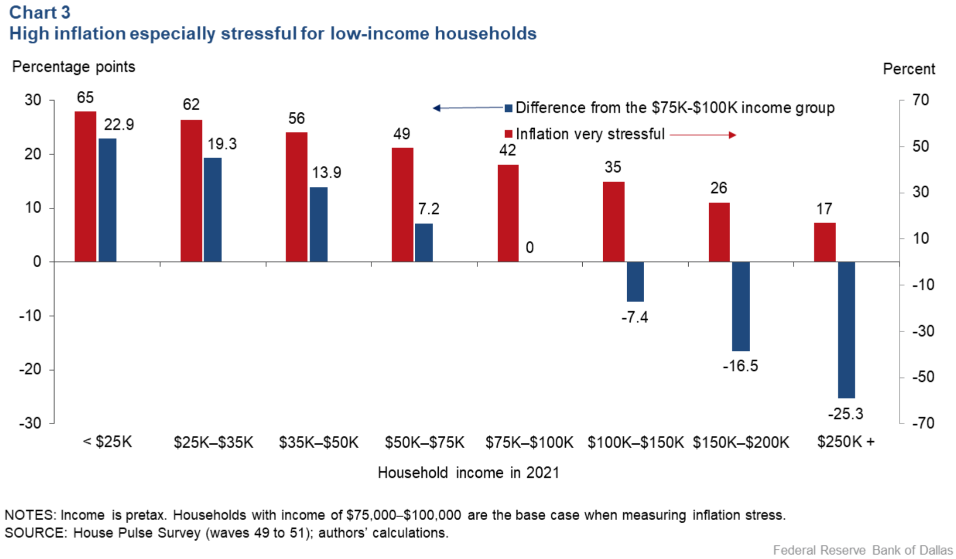
Inflation stress disproportionately impacts low-income households hardest due to the following reasons:

Low-income families allocate the largest portion of their salaries to essential needs such as food, gas, and rent. Prices don't increase uniformly for all goods or across all places; the most substantial rises have been observed in the prices of food and gas.

Groups in the CPI basket and their weights in 2022*

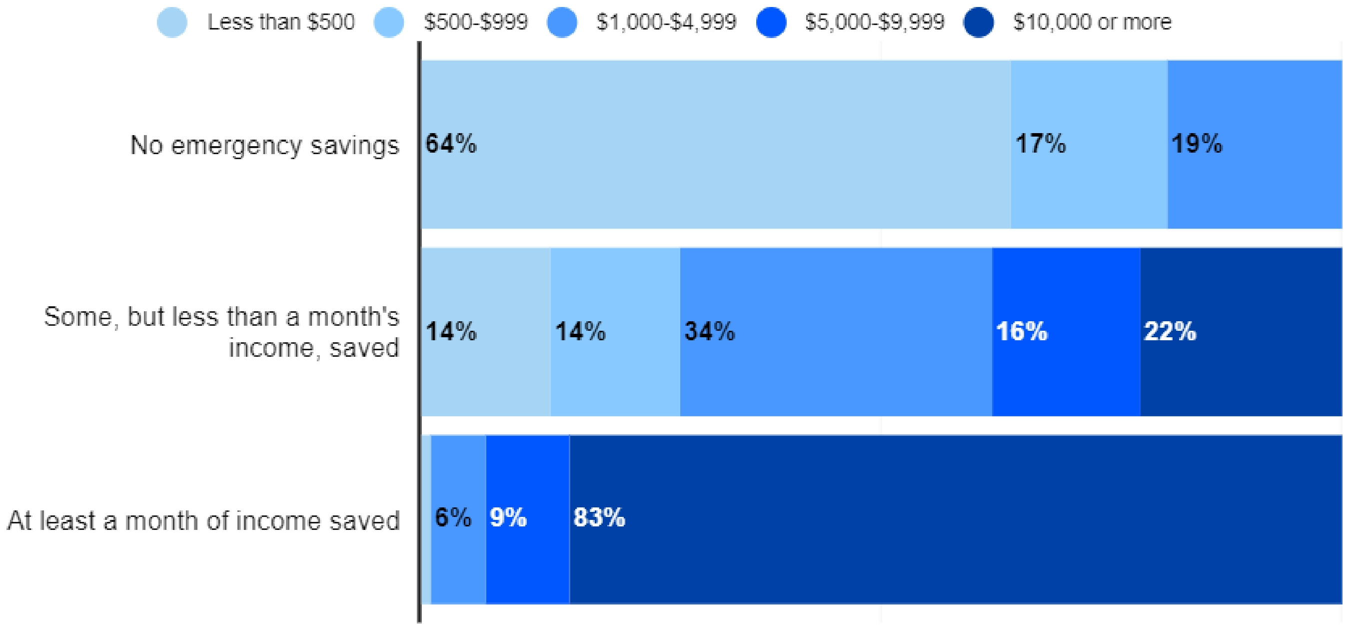
* Numbers do not add to 100 per cent due to rounding.

When prices rise, middle-income families may respond by opting for more affordable products or purchasing generic brands. However, low-income families lack the flexibility to make such adjustments because; in many cases; they are already choosing the most economic goods. Furthermore, they do not possess the financial capacity of higher-income households to stock up during discounted periods, buy in bulk and save, or defer purchases to take advantage of cheaper alternatives either online or elsewhere. These factors significantly contribute to the development of inflation, stress, and anxiety.



Inflation impacts not only the money spent on products and services but also savings. Low-income households frequently find themselves having to tap into their emergency funds to afford necessities. While it is true that low-income individuals received a larger pay rise than high-income workers, their salaries still fall short of the amount needed to offset the effects of inflation.

BANK ACCOUNT BALANCES, BY EMERGENCY SAVINGS LEVEL



Source: CFPB

Moreover, even if a family has savings, it doesn't grow at the same rate as inflation. Consider an individual with $100 in a savings account with a 1% interest rate. A year later, it will be $101. However, with a 2% inflation rate, this person would need $102 to maintain the same buying power as at the start. While banks may attempt to address high inflation by offering higher interest rates, savings often do not grow rapidly enough to offset inflation loss and the purchasing power of money continues to diminish.

Something that is often overlooked is the fact that rent is one of the largest drivers of inflation, and low-income households are most likely to be renters. Renters are more vulnerable to inflation compared to owner occupants with a mortgage because the latter typically has a low fixed-rate mortgage, which is not directly affected by inflation. On the contrary, renters have to contend with annual or more frequent rent reviews and the potential for significant cost increases.

By and large, countries that have recently faced the highest inflation rates are indeed the ones where low-income families and individuals experienced a much higher inflation rate than high-income groups. In October 2022, Latvia, Hungary, Lithuania, and Estonia all experienced very high inflation as well as high inflation inequality. However, the correlation is imperfect and there are several interesting outliers. Countries like Czechia exhibit much smaller inflation inequality than countries with similar inflation rates, including Bulgaria, Slovakia, and Poland. Countries such as Ireland and Italy, meanwhile, have experienced much higher inflation inequality than countries with similar inflation rates. Italy in particular, despite ranking close to the median EU inflation rate, has seen the highest inflation inequality in the EU.

Countries that have similar differences in how people spend money might still see different levels of inflation inequality. This happens when the prices of things that a certain income group buys change a lot in different ways between countries. For example, if the cost of energy goes up and causes inflation, it might not affect inequality as much if rich households spend more of their money on things that become more expensive quickly. The variation among countries can be attributed in part to the dissimilarities in the spending habits of their high-income segments. In contrast, the consumption patterns of lower-income households tend to be more alike across countries, with rent, food, and energy playing a predominant role. On the flip side, certain consumption categories that are more prevalent among wealthier households have experienced different degrees of price hikes..

Major Parties Involved

United States of America: The USA has recently faced its most rapid inflation rate in 40 years, impacting families nationwide. Inflation, as calculated by the Bureau of Labor Statistics, is designed to track the price increases in a typical U.S. household's basket of goods. According to their data inflation is currently at 7,2% for the lowest-income households, while the highest-income households experience a relatively lower rate of 6,6%. The disparity between these two income groups grew steadily throughout 2021, starting the year at just 0.16 percentage point but ending at 0.6 percentage point – near the highest it has been since 2010. The primary driver behind the widening gap has been the escalation of grocery and gas prices. This has made inflation run hotter for all households. However, given the proportion of low-income families spending on food and gas, it had affected them more.

Malta: Energy prices in Malta have been capped at their 2014 levels since the start of the COVID-19 pandemic. Given the dominant role of energy prices in driving recent inflation and therefore inflation inequality, this policy has contributed to the continuously low inflation and inflation inequality in Malta. Recently there has been a slight but noticeable increase in inflation inequality in Malta due to the rising food prices, which have a larger effect on lower-income households.

Czech Republic: Czechia serves as a notable example illustrating the impact of comparable consumption among different income groups. Despite experiencing a considerable year-on-year inflation, 15.5% as of October 2022, inflation inequality remains minimal at -0.33 percentage points, this indicates, contrary to expectations, high-income households encounter a slightly higher inflation rate than those with lower income. The primary reason contributing to this phenomenon is the closer resemblance between spending patterns of lower- and higher-income groups as they spend similar proportions of their consumption on various goods and services. This aligns with Chechia's reputation as a highly egalitarian country with low wage disparity. As well as food, natural gas has also undergone pretty high inflation, and these make up similar proportions of spending of lower and higher income households as well. Due to this reason food and gas prices did not drive up inflation inequality either.

Estonia: In Estonia, policy shifts have led to more unpredictable patterns. Specifically, the elimination of an electricity price cap in March 2022 promptly led to a surge in energy prices, subsequently causing an increase in inflation inequality. This implies a connection between the policy change and the observed economic impact.

Germany: The case of Germany shows that changes in the prices of specific things can also significantly affect how different income groups experience inflation. In this country, the gap between the spending of top and bottom income groups is quite notable with 25 percentage points. However, the country has a negative inflation inequality at 1.3, meaning that richer people encounter higher inflation than less wealthy people in Germany. Although the expensive energy prices did not truly affect inflation inequality, the rise in the price of cars did. That is why higher-income families are more exposed to inflation because they spend a larger share of their income on cars compared to their counterparts in Italy.

Italy: Italy shows how changes in price for specific things can remarkably influence how inflation is distributed between different income groups, similar to Germany. However, in Italy, there is a solid contrast between the expense of top and bottom groups which is a gap of 18 percentage points. However, unlike Germany, Italy has positive inflation inequality at 9.1 percentage points. The main cause of this high inflation inequality in Italy is the significant impact of rapidly increasing energy prices. Unlike in Germany, where the effect of expensive energy is balanced out by other categories, in Italy, the impact of high energy prices is not offset, leading to an overall higher inflation inequality in the country.

Previous Attempts to Solve the Issue

INDEXING SOCIAL BENEFITS IN THE UNITED STATES

With its longstanding practice, the Social Security Program in the United States has been adjusting benefits based on the Consumer Price Index (CPI) since the 1970s. The Social Security Administration makes annual cost-living changes to make sure benefits keep up with inflation which helps to protect the purchasing power of retirees and other beneficiaries.

PROGRESSIVE TAXATION

Nordic countries like Denmark, Sweden, Norway, and Finland have a history of progressive taxation. These countries implement higher tax rates on higher income brackets, contributing to a more equitable distribution of wealth and funding social welfare programs that benefit lower-income individuals.

GERMANY'S HOUSING ALLOWANCE

Germany provides a housing allowance called "Wohngeld" to help low-income individuals and families with meeting their housing costs. The amount is adjusted based on factors like income, rent, and family size.

REVALUATION OF SOCIAL BENEFITS

France periodically makes adjustments and revalues social benefits including family allowances and income support to keep up with the cost of living. This helps to protect the purchasing power of low-income families.

INTERNATIONAL MONETARY FUND (IMF) AND WORLD BANK SPRING AND ANNUAL MEETINGS

These meetings provide a platform for discussions on global economic challenges, including inflation and its impact on different income groups. The institutions address policy responses and strategies to promote economic stability and development.

Possible Solutions and Approaches

INCOME SUPPORT PROGRAMS

Implement direct cash transfer programs that specifically target low-income families. These programs could provide basic assistance by covering the cost of food, gas, education, or rent for example. A targeted approach ensures that it is provided for those who need it the most.

MINIMUM WAGE ADJUSTMENTS

Establish regular reviews of the minimum wage to assess their adequacy in light of inflation and cost of living. This can involve forming a wage board or commission that includes representatives from the business sector, labor, the government, and a human rights representative to discuss and determine immediate adjustments. Additionally, when setting minimum wage levels, regional variations of the cost of living should be debated. Some areas may have higher expenses and adjusting minimum wages accordingly can better reflect the economic realities of different regions.

AFFORDABLE HOUSING INITIATIVES

Explore the possibility of implementing rent control measures so that the rate at which landlords increase rents can be limited. This helps to prevent sharp spikes in housing costs, providing stability for low-income renters. It would also solve the problem of regional differences in the cost of rent, making it easier for renters to find a suitable home for their families. Another solution could be to increase public and private investments in the development of affordable housing. This includes supporting initiatives that focus on constructing new housing or rehabilitating existing structures to create more options for low-income families.

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