in brief...

The wellbeing costs of inflation inequalities

Some people face sharper increases in the prices they pay than others – and since inflation makes everyone miserable, they also experience greater loss of happiness. **Alberto Prati** assesses the costs of such inflation inequalities in France, and explains why measuring them is important for a policy agenda that places citizens' wellbeing at its centre.

Inflation inequalities refer to the fact that different people experience different inflation rates, over the same period and in the same country. This dispersion is an acknowledged economic fact (Jaravel, 2021), and can be observed in everyday life.

Take the following example: imagine that your energy bill is 10% higher than last year. Your consumption hasn't changed, but prices have. This is undoubtedly annoying, and this is how inflation often feels: paying more for something for no apparent reason.

When you share your frustration with your sister, she will tell you that she has not noticed a change, since her monthly rent includes bills. Your dad will say that the situation is not so bad, but then the council is subsidising part of his bills. A friend will tell you that her situation is even worse, since her provider has increased prices by more than 20%. Who's right about inflation? Everyone is. The point is that inflation is not the same for everyone.

Typically, the inflation reported by statistical offices and in the media refers to the average level of inflation in the country. An increasing cost of living has long been one of the most feared phenomena in western countries (Shiller, 1997) and now that this fear has re-emerged, the inflation index has gained much attention. In 2022, Europe, the UK and other places that have not experienced major inflationary periods for four decades registered record levels of inflation, with the consumer price index in the UK hitting a peak of 11.1% in October 2022.

It might come as no surprise that inflation makes people more miserable. This is true not only when wellbeing is measured in objective materialistic terms (how much people consume), but also when subjective psychological measures are used (how satisfied people feel). Research published two decades ago was the first to show that levels of life satisfaction move systematically with the nation's rate of price change (Di Tella et al, 2001). Since then, several studies have confirmed this finding. But what about inflation inequalities, do they matter too?

Assessing the wellbeing costs of inflation inequalities involves complex measurement challenges. Ideally, one would like to monitor a large sample of the population

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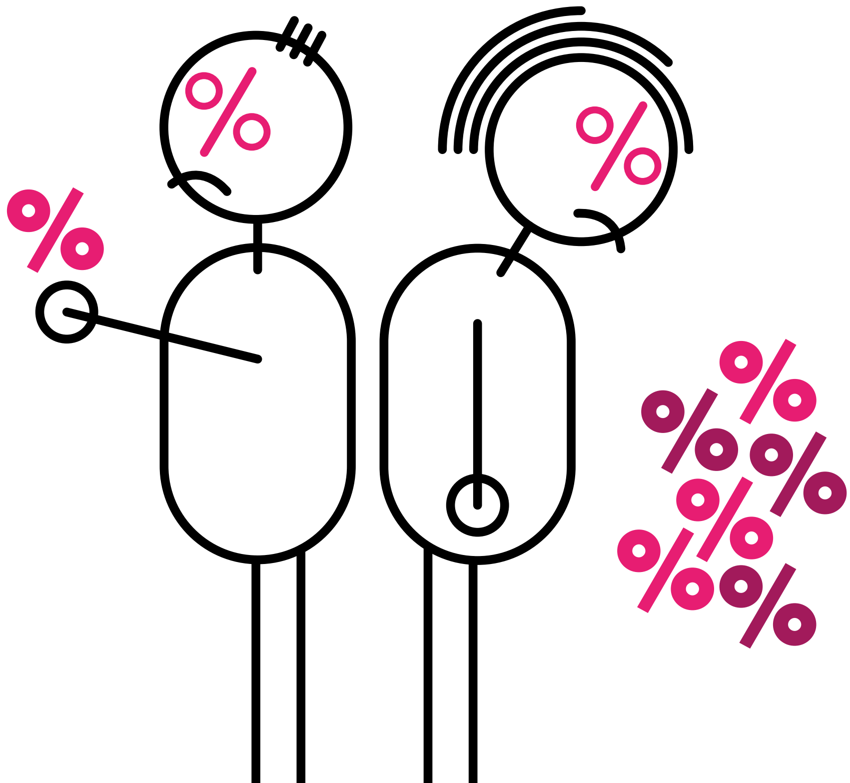

observing what each person buys, how much they pay for each product and recording how satisfied they feel. Unfortunately, existing data collected by retailers and statistical institutes do not allow for this – not least because they do not ask people to report their wellbeing. In a new study, I overcome this problem by using recent data from France, collected by the Wellbeing Observatory.

I use two complementary approaches to analyse these data. First, I look at consumers' opinions about how much prices have changed over the past year. Some people experience higher inflation rates than others, and asking them how much prices have changed is a natural way to learn about these differences. Since answers will only be an approximation of the actual inflation rates, I apply some behavioural and statistical techniques to account for noise and biases.

Second, I create a dataset containing information on consumption habits and subjective satisfaction. This allows me to split the sample between those who commute by car and other means (bike, bus, etc.) and study how these groups reacted differently to changes in the price of petrol.

The two analyses reveal that inflation inequalities matter. At a given point in time, a consumer reporting one percentage point higher inflation than another consumer endured a significant satisfaction gap. This gap is larger than the one associated with a 1% difference in income.

Importantly, the effect is due only to inflation inequalities within the same period, and it adds to the effect of raising prices over time. These results are confirmed when comparing groups of consumers. Those who commute by car report higher levels of inflation and lower levels of satisfaction with living standards when the price of petrol increases. These differences are observed even in a context of general price stability when average inflation is particularly low.

When prices are stable, inflation inequalities are smaller, and so is their effect on wellbeing. This is arguably why inflation differences have not received much attention to date. But between March 2020 and March 2022, the average inflation gap reported by consumers in France more than tripled. If inflation inequalities increase, their total effect will increase too. The wellbeing cost of the inflation crisis would be underestimated if looking at aggregate figures only.

In the context of a cost of living crisis, this study is a warning against considering only the average level of inflation, rather than its dispersion among citizens. In September 2020, during her first year in office, the President of the European Central Bank, Christine Lagarde, stated that: "We need to keep track of broad concepts of inflation that capture the costs people face in their everyday lives and reflect their perceptions".

Inequalities should be part of this broad concept of inflation. Measuring inflation inequalities is both important and urgent for a policy agenda that places citizens' wellbeing at its centre.

It is important to think beyond the average level of inflation to how it varies among people

This article summarises 'The Well-Being Cost of Inflation Inequalities' by Alberto Prati, CEP Discussion Paper No. 1870 (https://cep.lse.ac.uk/pubs/download/dp1870.pdf). A version of it first appeared on the LSE European Politics and Policy blog as 'The Well-Being Cost of Inflation Inequalities'.

Alberto Prati is an assistant professor in economics at University College London, a research fellow at the University of Oxford and an associate in CEP's wellbeing programme.

Further reading

Rafael Di Tella, Robert MacCulloch and Andrew Oswald (2001) 'Preferences over Inflation and Unemployment: Evidence from Surveys of Happiness', *American Economic Review* 91(1): 335-41.

Xavier Jaravel (2021) 'Inflation Inequality: Measurement, Causes, and Policy Implications', *Annual Review of Economics* 13(1): 599-629.

Robert Shiller (1997) 'Why Do People Dislike Inflation', in *Reducing Inflation: Motivation and Strategy* edited by Christina Romer and David Romer, University of Chicago Press.

As prices increase, the gap in life satisfaction between those experiencing lower or higher inflation increases