

## Box E: No quick respite from the cost-of-living crisis

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The analysis in NIESR's Spring Outlook published in May 2022 examined the soaring prices of necessities such as energy and food and its effects on low-income households (Bhattacharjee et al., 2022). Using NIESR's regional, microsimulation and global macroeconomic models (NiReMS, LINDA and NiGEM, respectively), the distributional consequences of rising inflation were projected for households in 2022-23 across the income distribution, with a focus on how effective the policies announced in the then Chancellor's Spring Statement were in offsetting at least part of the fall in disposable incomes; see Figure 2.1 and Table 2.6 in Bhattacharjee et al. (2022).

In May 2022, the then Chancellor announced a package of further support to tackle the cost-of-living crisis. Unfortunately, the current inflation episode is not temporary, and its effects will be very persistent. Further rises in energy bills are forthcoming in autumn and an even further rise in the energy price cap is predicted for early 2023. While inflation may get somewhat moderated in the medium run, the prices particularly of energy and food are predicted not to move southwards. This implies that hardship due to cost-of-living rises will persist into the next financial year 2023-24. The purposes of this box are to: (a) revisit NIESR's previous analysis to determine the impact of the May 2022 emergency grants; and (b) project the distributional impacts forward through to 2023-24. Part of this work was conducted in association with The Guardian and is reported elsewhere (de Hoog et al., 2022).

Bhattacharjee et al. (2022) reported that the rising prices of necessities hit hardest low-income households who spend a disproportionate share of their budgets on food and energy. A key finding from this analysis was that the policy choices at the time, designed to help with this cost-of-living crisis, were having a minimal effect and, in some cases, were cancelled out by other policy decisions, such as the rise in National Insurance Contributions (NICs) from April onwards, which largely negated the increase in the threshold of NICs from £9,880 to £12,570 that came into effect in July.

Consequently, the net effect of inflation and the support measures meant the poorest households were seeing the greatest fall in their real incomes. Our analysis uncovered that 1.5 million households across the UK (5 per cent) would face food and energy bills greater than their disposable income, and that a further 250,000 households would slide into destitution (a measure of extreme poverty), bringing the total to around 1 million. We therefore concluded that further government support was needed to help the poorest households, with the expressed aim of equalising the fall in real incomes so that the burden of inflation is felt equally across the distribution. Our proposals included an uplift to Universal Credit of £25 a week, along with a one-off cash transfer of £250 to the 11.3 million lower-income households.

On 26 May, the then Chancellor Rishi Sunak announced a further package of support with two features. The first was a targeted one-off cash transfer of £650 to the poorest households on Universal Credit. This approximately equates to our proposal of introducing a £25 Universal Credit uplift for six months. The second was a universal grant of £400 to all households distributed via a rebate on energy bills. While they were patchy (neither progressive nor regressive) and not well targeted, these measures were nevertheless welcome. They cushioned part of the adverse impacts of the cost-of-living crisis on households particularly in the bottom half of the income distribution.

Using NIESR's microsimulation model LINDA (NIESR, 2016), we find that the net effect of inflation and previously announced support policies (in the Spring Statement) left the poorest households worse off than the rest, but when we add the new targeted help and the universal cash-grants (announced in May 2022) to the analysis, the impact on the hardest hit households is much more cushioned than before, as displayed by the flatter net-effect across the income distribution. In short, the targeted assistance NIESR called for in its Spring Outlook will help the poorest households whose real incomes will now not fall more than the median. Figure 2.1 in Chapter 2 of this Outlook graphically illustrate the effects and the detailed numbers are reported in Table E1.

**Table E1** Impact of Spring Budget and Cost of living on household finances, by income decile, in 2022-23

Aggregate	2022-23	Sources/uses of income	HHHs	Bottom decile	Decile 2	Decile 3	Decile 4	Decile 5	Decile 6	Decile 7	Decile 8	Decile 9	Top decile
62,000		Disp. Income	£14,800	14,300	19,600	21,100	23,900	29,400	37,700	46,900	62,800	105,100	260,600
[0.2%]		Spring Stmt. + May Effect	[2.8%]	[3.0%]	[4.1%]	[4.4%]	[2.5%]	[0.9%]	[0.7%]	[0.7%]	[0.3%]	[-0.2%]	[-1.0%]
-421	Income	- Benefits	£(771)	-780	-559	-492	-494	-497	-503	-387	-345	-227	-210
622		- NI threshold	£239	213	412	495	516	556	618	711	765	833	820
-678		- NI rates	£(53)	-45	-99	-122	-149	-201	-279	-402	-605	-1,206	-3,647
563		- May Emergency Grant	£1,000	1,050	1,050	1,050	725	400	400	400	400	400	400
62,100		<b>Net Income</b>	<b>£15,200</b>	14,800	20,500	22,000	24,500	29,700	38,000	47,200	62,900	104,900	257,900
13,500		Necessities	£28,400	11,200	10,300	10,400	11,300	13,100	15,800	16,400	17,600	14,900	18,700
[21.8%]		%	[192.5%]	[78.1%]	[52.6%]	[49.3%]	[47.3%]	[44.5%]	[41.8%]	[35.0%]	[28.0%]	[14.2%]	[7.2%]
4,900	Expenditure	- Food	£10,800	4,300	4,000	4,000	4,300	5,000	6,000	6,100	6,400	5,000	5,600
2,200		- Fuel	£5,100	2,300	1,900	1,900	2,000	2,300	2,700	2,700	2,800	2,200	2,500
3,100		- Transport	£4,300	1,600	1,600	1,700	1,900	2,400	3,000	3,500	4,100	4,300	7,100
[-2.1%]		(excess inflation >5%)	[-9.5%]	[-8.3%]	[-5.4%]	[-5.0%]	[-4.7%]	[-4.4%]	[-4.2%]	[-3.4%]	[-2.7%]	[-1.3%]	[-0.6%]
23,000		Discretionary	0	8,200	11,900	12,900	14,700	18,000	23,200	28,000	32,000	34,700	48,700
[37.0%]			[0.0%]	[57.1%]	[60.4%]	[61.1%]	[61.2%]	[61.3%]	[61.3%]	[59.7%]	[51.1%]	[33.0%]	[18.7%]
36,500		Consumption	£28,400	19,400	22,200	23,300	26,000	31,100	38,900	44,400	49,600	49,600	67,400
[-1.9%]		Spring Stmt. + May + Infl.	[-6.7%]	[-5.3%]	[-1.3%]	[-0.6%]	[-2.2%]	[-3.5%]	[-3.5%]	[-2.7%]	[-2.4%]	[-1.5%]	[-1.6%]

Source: LINDA

Notes: HHHs refers to 'Hardest Hit Households' for whom the cost of necessities (food and energy) exceeds their disposable income, so that they are left with the choice of eating or heating. Amounts reported are average annual nominal figures in pounds sterling (percentage of household disposable income in brackets).

Although the policies employed are effective in equalising the burden of the cost-of-living crisis, our analysis suggests their combination could have been enhanced. In particular, the universal cash grant received the bulk of criticism for its wastefulness in giving a significant cash-transfer to wealthy households and not having the mechanism necessary to avoid individuals with two homes receiving the payment twice.

Our criticism in this regard is more nuanced. We do not take the view that universal cash-transfers are themselves a waste, but more a necessary evil. The reason is that if we only attempt to tackle this cost-of-living crisis with targeted policies, there is a greater risk of creating an insider-outsider problem, where one household that receives welfare is assisted but those who may also need help, as they have a very similar income, do not. When we start to attach conditions to support measures of this kind, we increase the risk of people falling through the cracks. Therefore, it is eminently sensible to follow-up targeted support measures with more universal cash-transfers to minimise this risk.

The challenge with this approach is not with wealthy households getting support they do not need (that is a necessary inevitability), but how to balance this against targeted support measures. Our analysis, shown in Figure 2.1 and Table 2.2, suggests more support could be given to those in the bottom decile. We therefore take the view that the combination of policies was sensible, but a better balance could have been achieved by raising the generosity of the targeted support at the cost of reducing the size of the universal part of the support measures.

We also need to remember that our analysis assumes that households receive support measures all at once. In reality, this is not quite the case, as households eligible for the £650 cost-of-living payment through Universal Credit have only recently received the first half of this payment, with the second scheduled for 'Autumn 2022'. From 26 May to 14 July,<sup>1</sup> those households identified as 'hardest hit' had no additional support.

1 This is the earliest point at which the payment could be made, households could still expect to wait until the 31 July at the latest for their cost-of-living payment.

Our previous recommendations only looked at the period ending in October, as this is when the energy price cap is due to be increased. Therefore, although our recommendations are closely aligned with the Chancellor's package of support for this period, they will only remain so if the Chancellor chooses to update these support measures for the forthcoming six months. Given the energy price cap is due to increase even further, the next round of support measures will have to be even more generous than the last to keep up with these rising prices. To achieve this, we recommend a Universal Credit uplift of £25 per week for at least six months from October 2022 to March 2023 and an increase in the energy grant from £400 to £600 for those 11 million households.

Further, as discussed earlier, the cost-of-living crisis is predicted to persist in the medium run. This is because of two effects. The first effect is due to astronomical prices, particularly of energy and food, that are now rising sharply but will continue to stay high even if the rate of inflation falls somewhat in 2023-24 (see Chapter 1). Second, as discussed in Chapter 2 and Box C, accumulated savings of poor households are predicted to fall sharply, leaving them with little or no headroom to cushion the impact of persistently high prices of necessities. The continued effects of high prices across the distribution of households by income deciles in reported in Table E2.

**Table E2** Impact of Spring Budget and Cost of living on household finances, by income decile, in 2023-24

Aggregate	2023-24	Sources/uses of income	HHHs	Bottom decile	Decile 2	Decile 3	Decile 4	Decile 5	Decile 6	Decile 7	Decile 8	Decile 9	Top decile
65,900		Disp. Income	£19,300	19,200	21,200	27,100	34,100	42,600	51,300	64,900	84,900	118,000	195,700
[-0.9%]		Spring Stmt. + May Effect	[-3.1%]	[-3.5%]	[-2.0%]	[-0.9%]	[-0.8%]	[-0.8%]	[-0.3%]	[-0.7%]	[-0.7%]	[-0.9%]	[-1.1%]
-409	Income	- Benefits	£(713)	-773	-591	-456	-468	-471	-280	-379	-336	-243	-167
491		- NI threshold	£191	159	263	392	441	484	614	574	607	664	659
-699		- NI rates	£(67)	-57	-94	-170	-261	-333	-491	-617	-899	-1,437	-2,631
65,300		<b>Net Income</b>	<b>£18,700</b>	18,600	20,800	26,900	33,800	42,200	51,100	64,500	84,200	117,000	193,600
21,500	Expenditure	Necessities	£35,500	12,000	14,300	15,700	18,100	21,000	17,600	22,100	26,500	33,900	40,400
[32.6%]		%	[183.7%]	[62.0%]	[67.6%]	[57.8%]	[53.0%]	[49.4%]	[34.3%]	[34.0%]	[31.2%]	[28.8%]	[20.7%]
7,600		- Food	£13,600	4,600	5,600	6,000	6,900	7,900	6,400	7,900	9,300	11,500	12,300
3,600		- Fuel	£7,500	2,600	2,800	2,900	3,300	3,800	2,900	3,700	4,300	5,200	5,700
5,400		- Transport	£5,300	1,800	2,300	2,700	3,400	4,200	4,100	5,400	7,000	10,100	14,600
[-3.7%]		(excess inflation >5%)	[-23.1%]	[-7.9%]	[-8.2%]	[-6.8%]	[-6.3%]	[-5.8%]	[-3.8%]	[-3.8%]	[-3.4%]	[-3.1%]	[-2.1%]
38,400		Discretionary	0	12,000	17,800	19,700	23,800	28,800	32,600	41,300	50,300	69,900	92,500
[58.3%]	%	[0.0%]	[62.2%]	[83.7%]	[72.8%]	[69.8%]	[67.7%]	[63.5%]	[63.5%]	[59.3%]	[59.3%]	[47.3%]	
59,800	Consumption	£35,500	23,900	32,100	35,400	41,900	49,800	50,100	63,300	76,800	103,900	132,900	
[-4.6%]	Spring Statement + Inflation	[-26.2%]	[-11.4%]	[-10.2%]	[-7.7%]	[-7.1%]	[-6.6%]	[-4.1%]	[-4.5%]	[-4.1%]	[-4.0%]	[-3.2%]	

Source: LINDA

It is clear that the continued impact of inflation will persist into 2023-24 and will be highly regressive, to devastating effect particularly upon poor households at the bottom of the income distribution. These households will also lack savings and access to financial markets. Many will be left to seek support from foodbanks and charities but many others may also lack such support and be left with no option but to borrow from loan sharks. It is also interesting that in the current prime-ministerial contest, there is greater focus on tax cuts than the urgent necessity to continue support for the most vulnerable in our society. Our analysis suggests that there is no substitute to continued targeted welfare.

In summary, although the support measures were generous, they fell short in key areas: too much was spent on expensive universal measures rather than on making targeted measures more generous, the support took too long to administer (leaving households without any support for months) and the support will need to be extended in October when the energy price cap increases further. Importantly, we are in the cost-of-living crisis for the long haul and targeted welfare support needs to continue.

## References

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