

Turning the Corner on Inequality?

di Daniel Gros

The pandemic and the Ukraine war have wrought significant hardship for many poorer countries and households. But average figures and blanket statements fail to account for important differences across income groups, not least the disproportionate increase in income gains for those at the bottom of the distribution.

MILAN – Economic policymakers around the world have struggled to stem rising inequality – a trend that has impeded [economic growth](#), fueled populist [electoral victories](#), and jeopardized [liberal democracy](#). It was thus widely and understandably feared that unskilled workers [would suffer deeply](#) as a result of the COVID-19 crisis and, more recently, the energy-price shock that followed Russia's full-scale invasion of Ukraine. But, in both cases, the impact has been relatively benign.

After the initial pandemic shock in early 2020, economies and job growth rebounded strongly. Thanks to the robust recovery, together with far-reaching government support programs, [income inequality fell](#) by most measures, especially in the United States, owing to substantial cash transfers to households, but also [throughout Europe](#), where government income support was more moderate.

Before the pandemic recovery was complete, however, another shock arrived: Russia launched its full-scale invasion of Ukraine, and energy prices spiked. But not all energy shocks are created equal. Whereas in the past they were driven largely by crude oil prices – which peaked immediately after the invasion, but are now in line with the pre-war average – natural gas is the main problem today. While natural-gas prices have fallen from their post-invasion peak in the summer of 2022, they remain 2-3 times higher than the pre-2021 average.

This is not a problem for the US. On the contrary, as a (small) net exporter of natural gas, the US has benefited from the energy-price shock, as its terms of trade have

improved (export prices have increased by more than import prices). As a result, the country, in the aggregate, can consume more.

But while high gas prices have made the US a little bit richer, they have made Europe substantially poorer. Because Europe imports most of its natural gas, consumers and firms are still paying significantly more for energy than they were before the war, and the eurozone's terms of trade have deteriorated, implying an [income loss of close to 2% of GDP](#).

With wage growth lagging behind inflation, real wages have fallen sharply throughout Europe (they have remained [roughly constant in the US](#)), creating the impression that inequality has increased. But the average values might be misleading. After all, wage growth is not necessarily consistent across income groups, and the inflation rate, as measured by the consumer price index, does not reflect differences in cost-of-living fluctuations across the income distribution.

Both [across](#) and [within countries](#), lower-income households tend to spend a larger share of their budget on energy than their high-income counterparts. In Romania – one of the European Union's poorer members – energy and food account for 25% of all [consumption expenditure](#), compared to 13% in much wealthier Germany. At the same time, the bottom quintile of the income distribution within Germany [spends more](#) on non-transport energy (8%) than the top quintile (5%). This means that, when energy prices increase, the official inflation rate might understate the extent to which poorer households lose purchasing power.

But other forces might offset the increase in energy costs. For example, poorer households tend to rent, rather than own, their residences, and rents have increased more slowly than the overall price level.

Such effects do not necessarily fully offset increased energy prices. If one measures the impact of inflation on households at various income levels, adjusted for their group's consumption patterns, one does find [some cases](#) where the effective inflation rate for the lowest-income quantile is several percentage points higher than it is for the richest quantile. This phenomenon is especially prevalent in poorer countries.

But there are also cases where low-income households have suffered a smaller loss in purchasing power than wealthier households. This is the case in Germany, where home ownership is less common, and France, where the price of energy has been kept

low for households. Since these two countries account for a significant share of the eurozone economy, the average difference between the purchasing-power losses suffered by the richest and the poorest households in the eurozone is small.

Moreover, in the US and some European countries, wages are increasing faster at the bottom end of the income distribution – what in the US has been called “[unexpected wage compression](#).” In [Germany](#), unskilled employees’ wages have increased by about 8% over the last year, while senior specialists or executives have secured increases averaging less than 2%.

Observers are not wrong to highlight the hardship that the pandemic and the Ukraine war have wrought for many poorer countries and households, some of which struggled to keep warm this winter. But average figures and blanket statements fail to account for important differences across income groups, not least the disproportionate increase in income gains for those at the bottom of the distribution.