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High inflation has disproportionate adverse impact on low-income utility customers.

NOTE TO READERS

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While utilities seek rate relief due to recent high inflation, low-income customers are particularly harmed by spiraling inflation trends.

In recent rate cases, public utilities have increasingly cited spiraling inflation not only as a reason for seeking higher rates generally, but also as a reason to seek higher equity returns in particular. According to utility witnesses, high inflation increases the "risk" of a public utility investment, thus meriting having regulators approve higher profits to protect utility investors.

The discussion below presents how, and why, inflation disproportionately harms low-income ratepayers. If a public utility commission thus does its job correctly, in balancing ratepayer and investor interests, the high rate of inflation should actually be reason to mitigate the harms of increased rates through adoption of a lower equity return.

The Balancing Requirement.

Establishing a return on equity is fundamentally predicated on balancing customer and investor interests. It is necessary for a state utility commission to understand the customer interests in order to appropriately balance them against the competing investor interests.

It is fundamental "black letter" law that the obligation of a utility commission in deciding on the appropriate return on equity (ROE) and the reasonable mix of debt and equity securities should balance consumer and investor interests. (*FPC v. Natural Gas Pipeline Co.*, 315 U.S. 575, 606-607, 608). Indeed, of the consumer issues that are important drivers of the just and reasonable

ROE determination, one of the most significant is the concern about affordability. If a sizable portion of customers cannot afford to pay the rates approved by a commission, that commission can hardly be said to have approved just and reasonable rates.

In sum, the process of setting a reasonable return on equity does not exclusively consider the interests of investors. Instead, the courts have consistently noted that setting a reasonable return on equity must involve a balancing of the interests of investors and ratepayers. To the extent that the impacts of inflation on investor interests are considered, therefore, the impacts of inflation on ratepayer interests must be considered as well.

The Impacts of Inflation on the Poor

The impact of inflation is felt most severely by low-income households. Research by the U.S. Department of Labor's Bureau of Labor Statistics, the agency that calculates and reports the "rate of inflation" (i.e., the Consumer Price Index [CPI]) each month, reports that "consumers with different incomes experience inflation quite differently."[1] According to this research, households earning lower incomes spend a higher share of their household budget on household necessities such as rent, food and medical care. Rent, food at home, medical care, and household utilities, are all expenditures on households goods and services that cannot be reduced in the way that discretionary household spending can be.

Household budget shares of expenditure items for lowest and highest income quartiles (2017–2018)[2]

Expenditure	Lowest Income Quartile	Highest Income Quartile
Rent (including owner's equivalent rent	34.93%	27.93%
Food at home	9.44%	6.58%
Medical care	8.36%	8.09%
Household utilities	4.36%	2.73%
Motor fuels	3.46%	3.42%
Motor vehicle operation	3.44%	3.40%
Telephone service	2.32%	2.00%

This difference in the consumption basket of lower and higher income households is significant in that the prices of goods and services that had larger budget shares for lower income households have risen faster than all other items. In particular, the BLS researchers found, "prices for motor fuel, medical care, fuel and utilities, and shelter rose faster than the overall average. . ."[3] "Because the lowest income households dedicate more of their spending on these categories," the BLS researchers found, "their overall inflation rates grew faster than the highest income households."

[1] Klick and Stockburger (December 2022). Spotlight on Statistics: Inflation Experiences for Lower and Higher Income Households, U.S. Department of Labor, Bureau of Labor Statistics, available at https://www.bls.gov/spotlight/2022/inflation-experiences-for-lower-and-higher-income-households/home.htm

[2] Id.

[3] Id.

Average price change by item, 2005–2020 (starred items defined by BLS to be household necessities)	
Item	2005–2020 average 12-month change
Tuition, other school fees, and childcare	4.03%
Motor Fuel*	3.45
Medical Care*	3.28
Rent*	3.06
Food away from home	2.86
Fuel and utilities*	2.71
All items	2.00
Food at home*	1.89
Lodging away from home	1.16
Recreation	0.74
New and used motor vehicles	0.43
Apparel	-0.10
Telephone services*	-0.20

Similar findings were reached by researchers at the Federal Reserve Bank of Dallas.[4] These researchers found that:

> Families have grappled with surging prices over the past 18 months, as the cost of meeting basic needs rose. Consumer prices were 7.1 percent higher in November 2022 than a year earlier.
>
> Although inflation may have peaked, prices remain elevated, with food costs up 10.6 percent, gasoline rising 10.1 percent, rent increasing 7.9 percent and medical care services up 4.4 percent.
>
> Drawing upon recent household survey data, we show that high inflation is disproportionately hurting low-income households, including Black and Hispanic households and renters.[5]

This higher inflation places a greater stress on low-income households. The findings of the Federal Reserve researchers explained the "stress" being placed on households by high inflation:

> Prior research suggests that inflation hits low-income households hardest for several reasons. They spend more of their income on necessities such as food, gas and rent—categories with greater-than-average inflation rates—leaving few ways to reduce spending . When prices rise, middle-income households may react by consuming cheaper goods and buying more generic brands. Low-income households do not have the same flexibility; in many cases, they are already consuming the cheapest products.
>
> Additionally, many low-income households lack the ability of higher-income households to stock up when prices are discounted, buy in bulk and save, delay purchases if there is an opportunity to save in the future or buy more cheaply online. Low-income households are also likely to have smaller cash buffers to tide them over a period of high inflation.
>
> The recent Household Pulse Survey data confirm these tendencies. Households with

[4] Jayashankar and Murphy (January 2023). High inflation disproportionately hurts low-income households, Federal Reserve Bank of Dallas, available at https://www.dallasfed.org/research/economics/2023/0110#:~:text=Low%2Dincome%20households%20most%20stressed,few%20ways%20to%20reduce%20spending%20.

[5] Id.

> incomes ranging from $25,000 to $35,000 in 2021 were about 19.3 percentage points more likely to be very stressed by inflation than households with incomes in the $75,000 to $100,000 range.

The data is clear and it is consistent. Lower income families expend a greater share of their income on necessities (which tend to have higher inflation rates); have smaller financial cushions; and may have less of an ability to switch to lower-priced alternatives. As Lael Brainard, a member of the Board of Governors of the Federal Reserve System, concluded, "All Americans are confronting higher prices, but the burden is particularly great for households with more limited resources."[6]

The Standard Term: "Inflation Inequality"

It is useful to understand that the notion that inflation disproportionately adversely affects the poor is not a new conclusion. And it is not simply an argument that has been developed to respond to public utility cries for additional profit. The concept is know as "inflation inequality" and it has been studied for years.

An issue brief by Columbia University's Center on Poverty and Social Policy, for example, reports that

> Recent research also shows that prices have risen more quickly for people at the bottom of the income distribution than for those at the top —a phenomenon dubbed "inflation inequality." An implication of this new finding is that we may be underestimating income inequality and poverty rates in the United States.[7]

They report further that their:

> adjusted inflation index indicates that 3.2 million more people are classified as living in poverty in 2018, and that real household income for the bottom 20 percent of the income distribution actually declined by nearly 7 percent since 2004. These results show that inflation inequality significantly accentuates both the incidence of poverty and income inequality.[8]

The Conceptual Findings in Brief

It may perhaps be as important to understand the *why* of the disproportionate impacts on low-income households as it is to understand the specific numbers. Based on work at its Center for Poverty and Inequality Research, the University of California--Davis Office of Research concluded unequivocally that "it's clear that inflation and recession do not impact everyone equally."[9] Marianne Bitler, a UC-Davis professor and researcher at that Center, explained:

[6] Brainard (April 2022). Variations in the inflation experiences of households, available at https://www.federalreserve.gov/newsevents/speech/brainard20220405a.htm

[7] Winmer, et al. (undated). The Costs of Being Poor: Inflation Inequality Leads to Three Million More People in Poverty, Columbia University, Center On Poverty and Social Policy, available at https://static1.squarespace.com/static/610831a16c95260dbd68934a/t/61154aaa50053703a8898e64/1628785323000/The-Costs-of-Being-Poor-CPSP-Groundwork-Collaborative-2019.pdf

[8] Id.

[9] The Impact of Inflation and Recession on Poverty and Low-Income Households, available at https://research.ucdavis.edu/the-impact-of-inflation-and-recession-on-poverty-and-low-income-households/

For example, low-income households—who tend to be younger, and are more likely to be racial minorities and immigrants—spend a significantly higher fraction of their budget on necessities such as food, gasoline and heating. Higher-income families spend a higher fraction of their income on luxury goods. This means that when prices rise, they have more of a buffer and can cut back spending on these items to preserve their spending on necessities. To the extent that higher-income families have more savings, this also makes it easier for them to weather such shocks.

Another reason that some groups may be more affected than others is that when inflation occurs, prices do not increase uniformly for all goods or across all places. In the current period, food and oil prices have increased substantially more than prices for many other items. Since low-income families spend a relatively higher fraction of their budget on these goods, the larger increase in prices for these goods hurts low-income families more.

Households with fixed incomes, such as retirees, also tend to suffer disproportionately during inflation because, unlike wage and salary workers, their incomes cannot adjust to inflation.[10]

As can be seen, the UC-Davis findings closely parallel the findings by the Federal Reserve and Department of Labor researchers.

Summary and Conclusions

The testimony of utility witnesses generally do not present a complete story about the stress which inflation has placed on utility stakeholders. Just as inflation may have placed stress on the utility, it has also placed stress on utility ratepayers.

Indeed, the high inflation experienced in recent years has placed far more stress on lower income ratepayers than it has placed on others. Increasing energy prices, which would be exacerbated by the higher return on equity sought by a utility in a rate proceeding, is one of the major drivers of the inflation affecting lower-income households.

Given its obligation to balance the interests of investors and ratepayers in setting a reasonable return on equity, the greater adverse impacts that inflation has imposed on low-income ratepayers should be considered by a utility commission in establishing a return on equity.

In utility rate cases, even if low-income stakeholders do not file traditional rate-of-return testimony, they can, and should, present testimony explaining the particular adverse impacts of inflation on low-income households and insist that these impacts be appropriately balanced against the needs of utility investors in establishing rates.

Persons interested in more information about the disproportionate adverse impacts of inflation on low-income households as discussed in this newsletter can write for more information at:

roger [at] fsconline.com

[10] Id.

Fisher, Sheehan and Colton, Public Finance and General Economics (FSC) provides economic, financial and regulatory consulting. The areas in which *FSC* has worked include energy law and economics, fair housing, local planning and zoning, energy efficiency planning, community economic development, poverty, regulatory economics, and public welfare policy.