Lost in translation: What do Engel curves tell us about the cost of living?*

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May 27, 2016

Abstract

The Hamilton method for estimating CPI bias is simple and intuitively appealing and has been widely adopted. We show that the Hamilton method is internally inconsistent and conflates CPI bias with variation in cost of living across income levels. We demonstrate a method by which these two components can be disentangled. Our approach can recover changes in cost of living for any income level and we exploit this to study growth in the median income for the United States.

*Crossley acknowledges support from the ESRC-funded Centre for Microeconomic Analysis of Public Policy at the Institute for Fiscal Studies (CPP, reference RES-544-28-5001). We would like to thank Orazio Attanasio, Garry Barrett, Richard Blundell, Chris Carroll, Jeff LaFrance, Valerie Lechene, Ian Preston, David Stromberg, Guglielmo Weber, participants in a number of seminars and especially Bruce Hamilton for helpful comments. All remaining errors are our own.