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## The Age of Discontent: Italian Households at the Beginning of the Decade

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Italian Households at the Beginning of the Decade**

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March 2005

# **The Age of Discontent: Italian Households at the Beginning of the Decade**

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## ABSTRACT

### **The Age of Discontent: Italian Households at the Beginning of the Decade\***

In the Italian public debate growing attention has been recently paid to “household impoverishment”. Subjective indicators of economic condition show that this concern reflects a common sentiment of the Italian population. On the other hand, estimates based on the Bank of Italy’s Survey of Household Income and Wealth reveal a surprising stability of income distribution in the period 1993-2002, after the sharp widening amid the 1991-92 recession. A number of possible reasons that can account for this apparent inconsistency are investigated: data deficiencies; disappointed expectations; significant distributive changes across socio-economic groups which have cancelled out at the aggregate level; higher income mobility not captured by static inequality indices.

JEL Classification: D31, I3

Keywords: household confidence, income inequality, poverty, income mobility

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## Introduction

Between November 2003 and July 2004, a successful series of reports published in *Corriere della Sera*, now collected in Di Vico and Fittipaldi (2004), focused on the social situation of Italy: “The no longer middle class”, “the new wealthy”, “fathers and sons, same work”, or “good degree, minimum salary” were some of the headings. The same headings were echoed by reports in other newspapers, and soon taken up by academics, political commentators and research institutions. For instance, in a recent pamphlet on the “fears” of Italians, Castronovo wrote:

“The malaise of the middle class not only stems from a fall in its purchasing power and a loss of part of its accumulated savings, or from the difficulty of those in the lower ranges to make ends meet with the modest income they receive. It is also the outcome of the disillusionment and frustration generated by the uncertainty of their children’s future and bleak labour prospects” (2004, p. 104).

A special section entitled “Middle class and deep crisis”, with contributions by Bagnasco, Baldini, Atella and Rossi, and Cazzola, featured in the spring 2004 issue of *Il Mulino*. It opened with the following statement:

“The social contract of the post-war democracies, aimed at improving standards of living and consumption prospects in search of a more equitable distribution of the fruits of economic development, is falling apart. The brunt has been borne above all by citizens who are neither too poor, nor too rich, but are increasingly vulnerable – that part of the population which has experienced in the second half of the last century a growth in its consumption and possibility to accumulate wealth” (2004, p. 277).

In the same vein, in the introduction to the 2004 annual report of Eurispes, an independent social research institute, its President warned that

“... the spectre of poverty spreads across uncharted territories unknown until few years ago: the middle class is forced, for the first time in decades, to face the danger of an impending proletarianization. Upwards social mobility is hampered, while the path of downwards mobility is like a motorway. The mechanics of redistribution broke down and wealth is the more and more concentrated at the top of the social ladder. The society of the three thirds – which we had feared a few years ago – is now a reality: one third of hyper-protected, one third of poor, and one third at risk of poverty” (Fara, 2004, p. 7).

These are only cursory examples from a rich debate, but they adequately illustrate its many facets. Amidst the variety of themes and emphases, a recurrent feature is the question of “household impoverishment”. This attention to distributive issues, unusual for the Italian public debate, provides the motivation of this paper. We proceed in three steps.

The first question we ask is whether the public debate reflects a common sentiment of the Italian population, or whether it is just a media hype. The debate has been fuelled by newspaper reports, and it has often centred on case studies or anecdotal evidence that, however informative, are far from being statistically representative (e.g. Ichino, 2003). Our first task is then to verify whether there have been a worsening of households’ confidence and a general perception that poverty has been on the rise. This supposition appears to be corroborated by the evidence that we present in Section 1, where several subjective indicators of economic condition, their changes over time and their responsiveness to aggregate and individual shocks are analysed taking the European average as a benchmark.

We then move on to examine how income distribution has evolved since the early 1990s. It must be said at the outset that “household impoverishment” is a general expression that can be given different factual contents. Here, we take it in its more literal meaning to indicate that some significant modification in the distribution of economic resources has caused economic poverty or inequality to rise. This is what many people have probably in mind, but we are aware that other meanings are equally reasonable. We shall return to this issue in the conclusions. In Section 2, we provide fresh estimates from the Bank of Italy’s Survey of Household Income and Wealth – the main source on income distribution in Italy (e.g. Banca d’Italia, 2004a, 2004b) – that reveal that income distribution has remained surprisingly stable in the period 1993-2002, after the sharp widening during the 1991-92 recession, in spite of many changes in the labour market, the tax and social protection system and, more broadly, the economy. This evidence confirms that already available from the same source as well as from Istat’s expenditure survey, which is traditionally used to compute consumption-based measures of poverty (e.g. Istat, 2004a).

The last step is to attempt a reconciliation of the apparent inconsistency between the perceived distributive tendencies shown in Section 1 and the actual trends found in Section 2. We discuss in Section 3 a number of possible reasons: data deficiencies; disappointed expectations; the occurrence of significant distributive changes across socio-economic

groups, which have cancelled out at the aggregate level; and higher income mobility, which is not captured by static inequality indices and may have generated a sense of vulnerability among households. We draw the main conclusions in the final Section.

## 1. Do Italians really feel poorer?

To investigate whether Italian households manifest the sense of impoverishment stressed in the public debate we use data from three sources: the European Commission Business and Consumer Survey (BSC), the Eurobarometer, and the European Community Household Panel (ECHP). All three surveys ask interviewees to evaluate their own personal situation and the condition of their own country, both at the time of the interview and in the future. The first two surveys provide information updated to 2004, but because of their cross-sectional design they do not allow us to control for individual personal characteristics. This imposes some caution in interpreting the results – as in all interpersonal comparisons of subjective measures of well-being. For this reason, we exploit the longitudinal dimension of the ECHP to assess whether the *same* individual feels better or worse over time. Unfortunately, the ECHP information does not cover the more recent years as the survey was discontinued in 2001. In this Section, we focus on the difference between the answers of Italians and those of the citizens of other EU countries. (EU-15 refers to the EU member countries before the enlargement of May 2004.)

### *1.1 Recent evolutions in reported hardship*

Chart 1 reports a summary measure obtained from the BSC of the financial condition reported by households in Italy and in the remaining countries of the Euro area and the EU-15. This measure is computed as a weighted balance between the percentage of respondents declaring that their household's financial situation got worse in the previous 12 months and the percentage of respondents declaring that their household's financial situation improved (European Commission, 2004). Perceived hardship increased quite dramatically in Italy during the 1991-93 recession, climbing above the average levels in the EU; the gap gradually closed by 2001, as the indicator declined over the second half of the 1990s. The gap relative

to the rest of Europe opened again in the last two years, as the deterioration of the household reported financial situation was more acute. The impression is that cyclical slowdowns have in Italy an impact on family budgets, as perceived by respondents, more severe than elsewhere in Europe. The worsening of household confidence in Italy since 2001 is discussed at length by Golinelli and Parigi (2004).

[Chart 1 here]

Chart 2 is based on the Eurobarometer, a public opinion survey carried out by specialised polling firms for the European Commission since 1973 (see Saris and Kaase, eds., 1997). We look here at households' views as to their own financial situation and their country's general economic condition in the following 12 months. The deterioration of perceptions in Italy is evident in all of these domains, and is more pronounced than elsewhere in the Euro area or in the EU-15. The share of households' expecting a worsening of their financial condition increased by 11 percentage points from 2001 to 2004 compared with 5 percentage points in the EMU and the EU-15 (both excluding Italy). What is particularly striking is the difference in respondents' expectations about the condition of their own country: from 2001 to 2004 the proportion of Italians expecting a worsening rose from 35 to 55 per cent, at the same time as it declined from 47 to 41 per cent in the other EMU countries and from 45 to 40 in the rest of the EU-15.

[Chart 2 here]

Importantly, these negative perceptions do not have a short horizon. The share of individuals expecting a worsening of their personal financial condition in the next five years increased by more than 100 per cent in Italy from 2001 to 2004, compared with roughly 25 per cent, on average, elsewhere in Europe (Chart 3).

[Chart 3 here]

Ordered probit regressions of the probability of expecting improvements along the various domains (not reported here for brevity) suggest that it is mainly personal characteristics like age and education which play a role in affecting perceptions. Ideology matters too, but there is no change in the sign of the coefficient for the political affiliation dummies after the changes that occurred in 2001 in the ruling coalition in Italy. Ideology is likely to capture other factors affecting individuals' preferences.



## *1.2 Evidence from the European panel*

A key problem with the BSC and the Eurobarometer surveys is that they do not have a longitudinal design. This is a serious shortcoming in survey eliciting subjective evaluations of well-being, as different individuals may choose different metrics. To avoid interpersonal comparisons in levels, one can rely on longitudinal surveys where the evaluations of the same individual are recorded over time. The ECHP contains this information for 14 EU countries in the 1990s. Regrettably, however, the survey was discontinued in 2001, and hence we cannot capture the most recent evolution.

The ECHP aimed at collecting information on personal income and living standards by means of standardised national annual surveys elaborated under the co-ordination of Eurostat. In Italy it was conducted by Istat from 1994 to 2001. Austria and Finland joined in 1995 and 1996, respectively. In Germany and Luxembourg the ECHP was discontinued in 1996 and replaced by existing national panel surveys, while the data available for Sweden in the ECHP database are derived from a national cross-sectional survey. For these reasons, we exclude Germany, Luxembourg and Sweden from our analysis. (See EuroPanel Users Network, 2004, for an introduction to the database.) Several qualitative questions are concerned with households' satisfaction and their ability to live a decent life.

Chart 4 shows the average perceived ability to make ends meet from 1994 to 2001, expressed as deviation from the average score in 1996 (the first year for which we have all 12 countries). Answers range from 1 to 6, where 1 signals great difficulty in making ends meet and 6, at the opposite, that ends can be met very easily. Italy stands out as the only country where this subjective measure of the personal economic situation worsened after 1996: there was little change in Belgium, Denmark and Portugal, and a tendency to improve in the other countries. In Italy, Austria, France, Greece and Spain this indicator is negatively correlated with GDP growth (the continuous line in the Chart). The indicator is also highly responsive to individual shocks. Unreported regressions<sup>1</sup> suggest that individuals tend to report significantly higher levels of hardship when they experience unemployment spells or are exposed to changes in rental costs (if the household's head is a tenant). Conversely, when the

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<sup>1</sup> The regressions, available upon request from the authors, allow for both individual fixed effects and variables capturing various characteristics of the households. In presence of fixed effects, the coefficients on household characteristics capture the effects of variations in each given characteristic.

household's head obtains a permanent contract, self-reported ability to make ends meet improves. This happens both in Italy and in the other ECHP countries. Cross tabulations of average reported ability to make ends meet with socio-economic groups (also available from the authors) likewise indicate that individuals at lower income tenths report, on average, lower values for this variable.

[Chart 4 here]

Insights as to the evolution over time of perceptions come by regressing the answers provided by the individuals who have been interviewed in all waves of the survey (about 135,000 individuals of whom roughly 16,000 Italians) against a set of yearly dummies and individual fixed effects. These dummies identify a worsening or improvement of perceptions in the different countries, conditioning on the fixed characteristics of each person. Chart 5 shows the estimated coefficients of the yearly dummies (the histograms) and the associated 95 per cent confidence intervals (the bands). The coefficients are to be interpreted as deviations from the initial year (1994) which was in all countries a year of GDP growth. In Italy households' perceptions deteriorated after 1997 just while they were steadily improving in the other ECHP countries taken as a whole.

[Chart 5 here]

Becoming a tenant and, hence, facing the cost of rental housing is an important factor affecting households' reported ability to make ends meet. Rents markedly increased in Italy since 1994, notably in large urban centres. A question of the ECHP addresses specifically this issue by asking the extent to which housing cost is a financial burden for the household. Also on this ground an important asymmetry is observed between Italy and the rest of Europe. As suggested by Chart 6, since 1994 there was a marked deterioration in reported ability to meet housing costs in Italy while elsewhere perceptions steadily improved over time. Unsurprisingly, regression analyses allowing for personal characteristics suggest that the downward revision of the degree of satisfaction with the housing situation is more marked for tenants than for home-owners.

[Chart 6 here]

### 1.3 Summary

Italians do perceive a worsening of their own financial situation and of the economic conditions of their own country. They seem to react more strongly than elsewhere in Europe to a cyclical slowdown. The deterioration of expectations, however, is not confined to the short-term. The share of Italians expecting their own financial conditions to get worse *in the next five years* increased considerably in 2004. While expectations about the future recently deteriorated also in other EMU countries, the decline in expectations was not as marked and pervasive as in Italy. Although comparisons in the intensity of perceived decline are always problematic, we find important asymmetries between Italy and the other European countries also when we make use of longitudinal surveys. In particular, we observe a deterioration in the reported ability to make ends meet and in the assessment of housing costs.

## 2. Has the Italian income distribution worsened since the mid-1990s?

Does the worsening of households' perceptions documented in the previous Section reflect actual modifications in the distribution of economic resources? In this Section we provide new evidence based on the Survey of Household Income and Wealth (SHIW).<sup>2</sup> This survey has been carried out by the Bank of Italy since 1965 and is the main source on the distribution of personal incomes in Italy. We rely on data from the Historical Archive (HA) of the survey (version 3.0, released in April 2004), covering the years 1991, 1993, 1995, 1998, 2000 and 2002. The results relate to resident households and do not cover the institutional population, nor the homeless.

### 2.1 Definitions and measurement hypotheses

We use a comprehensive definition of household income, comprising wages and salaries, income from self-employment, pensions, public assistance, private transfers, income from real properties, imputed rental income from owner-occupied dwellings, and yields on

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<sup>2</sup> See Banca d'Italia (2004b) for the last release. Sources on income distribution are assessed by Brandolini and Cannari (1994) and Brandolini (1999). The available time series on income inequality and economic poverty are described and summarised in Brandolini (2004).

financial assets net of interest paid on mortgages. All components are recorded net of direct taxes and social security contributions. Monthly incomes are obtained by dividing annual totals by 12. We examine real incomes at 2003 prices by dividing nominal values by the deflator of the final consumption expenditure of households available in national accounts (HED). The HED is more consistent with our definition of income than the consumer price index (CPI), since it is based on a concept of expenditure including imputed rents on owner-occupied housing.<sup>3</sup> The HED shows a more pronounced dynamics of the cost of living than the CPI: between 1993 and 2002 it rose by an average 3.4 per cent per year, while the CPI went up by 3.0 per cent. We should note that the use of either of the price indices, as well as of any other aggregate price index, does not affect our results on relative poverty and inequality, because distributive measures discussed below are “unit invariant”, i.e. they are left unchanged by equal proportional increases (or decreases) of all personal incomes. This does not hold for absolute measures of poverty: if the cost-of-living index understates true inflation, rises in absolute poverty are underestimated and falls are overestimated, while the opposite happens when inflation is overstated. This has to be borne in mind in reading our evidence.<sup>4</sup>

The measurement of financial poverty and inequality requires several methodological choices. We adopt the following. The economic unit of aggregation, i.e. the basic unit for sharing of resources, is the household. This is defined as a group of persons living together who, independently of their kinship, share their income wholly or in part. We assume that the

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<sup>3</sup> As a result, the budget share of the expenses for dwellings is considerably higher in the HED than in the CPI. In 1995 actual and imputed rents accounted for 13.2 per cent of total household expenditure in the HED; in the same year, the share of actual rents paid by tenants in the CPI bundle was equal to 3.0 per cent.

<sup>4</sup> Whenever the inflation rate faced by the poor is higher (lower) than that faced by the rich, the measured inequality of real incomes is understated (overstated), unless a set of indices varying across income distribution is used in place of a single aggregate index. However, Baldini (2002), Istat (2003, pp. 77-9) and Del Giovane and Sabbatini (2004) observed that the variation of inflation rates across distribution was minor in the early 2000s. (But they accounted only for the diversity in the basket of goods purchased by households at different points of the distribution of equivalent expenditure, not for the different prices faced by each household.) Del Giovane and Sabbatini (2004, pp. 37-9), for instance, found that the decile-specific inflation rates rose in 2002 from 2.1 per cent for the poorest tenth of households to 2.6 per cent for the richest tenth; in 2003 these differences almost vanished. These results suggest that not allowing for inflation rates to vary across income distribution does not necessarily lead to understate real income gaps between the rich and the poor. On the other hand, it is far from obvious that a mechanical correction for these differentials is appropriate for the assessment of inequality. When the prices of luxury goods are increasing more rapidly than those of the other goods, it is debatable to state that the well-off have become relatively poorer than the rest of the society only because they buy more luxuries.

intra-household distribution is egalitarian and that the welfare unit is the person (rather than the household). This means that each household's income is counted as many times as the number of household's members.<sup>5</sup> Distribution is thus measured between individuals, attributing to each person the equivalent income of the household to which he or she belongs. In general, we use the OECD modified equivalence scale, recommended by Eurostat, which assigns value 1 to the first adult, 0.5 to any other person aged 14 or older, and 0.3 to any person younger than 14. In the estimation of absolute poverty, however, we employ the equivalence scale implicit in the absolute poverty lines estimated by Istat (2002a). This scale is "steeper" than the OECD modified scale, in the sense that the poverty threshold rises more rapidly as household size goes up, suggesting lower gains from cohabitation. *Ceteris paribus*, we may expect the composition of the poor to be more tilted towards large households with the absolute scale than with the OECD modified scale.

## 2.2 *Income inequality and polarisation*

Table 1 contains several statistics on the distribution of monthly real equivalent incomes among persons. According to the SHIW evidence, the fall in household incomes caused by the severe recession of the early 1990s continued for some time. In 1995 mean income was 5 per cent below its level in 1991. It then rose by an average 0.9 per cent in each of the seven following years, to 1,365 euros per month in 2002. (Note that this amount can be read as the monthly per capita net income adjusted for the economies of scales generated from cohabitation.) This U-shaped time pattern is shared by all income percentiles, except for the very top (90th, 95th and 99th) which tended to increase over most of the period. From 1991 to 1993 inequality grew considerably: the income share of the bottom 60 per cent of the population dropped by 3 percentage points, from 39.3 to 36.3 per cent of total income, to the benefit of the top 20 per cent (Chart 7). Between 1993 and 2002, however, the income shares accruing to fractions of population ranked by increasing income exhibited a basic stability; if

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<sup>5</sup> Regardless of the "welfare unit" under examination (household vs. person), all observations are weighted by the adjusted weights, available in the HA (variable *PESOF2*), obtained by post-stratifying the samples to re-establish the marginal distributions of components by sex, age group, type of job, geographical area and demographic size of the municipality of residence, as registered in population and labour force statistics. These weights should provide greater stability to intertemporal comparisons.

any, there was some very modest redistribution from the upper-middle classes (7th, 8th and 9th tenths) to the top tenth, mostly to the advantage of the richest 1 per cent.

[Table 1 here]

[Chart 7 here]

To obtain a summary view of the evolution of income inequality we examine two measures: the Gini index and the quintile ratio. The Gini index is the mean distance of each income from all other incomes, expressed as a proportion of the mean; it ranges from zero (perfect equality) to one (maximum inequality).<sup>6</sup> The quintile ratio is defined as the ratio of the income share of the top population fifth to that of the bottom fifth. This measure is chosen because it is one of the key social indicators adopted by the Laeken European Council to monitor the developments in social cohesion within the EU Member States (e.g. Atkinson et al., 2002; Giammusso and Tangorra, 2002).

The two indices have virtually the same temporal profile (Chart 8). After a sharp rise between 1991 and 1993, they show little change, save for a temporary increase in 1998. In 2002 the Gini index of equivalent disposable income equalled 33.3 per cent and the quintile ratio 5.8; in 1993 they were 33.6 and 5.9, respectively. As shown by the vertical bars in the Chart, the change between 1991 and any one of the subsequent years is significant at the 1 per cent level; between 1993 and 2002, on the other hand, none of the pairwise comparisons is statistically significant.

[Chart 8 here]

As outlined in the introduction, the recent debate has stressed the greater difficulties of the middle class. They do not necessarily manifest themselves in a rise of poverty and inequality. If “greater difficulties” mean higher uncertainty and income volatility, poverty ratios may remain about stable if movements up and down the income scale roughly cancel out. On the other hand, the middle class might “polarise” into (relatively) poorer and richer groups, but this movement could be offset by changes in other parts of the distribution. To

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<sup>6</sup> For the Gini index we provide standard errors calculated under the simplifying – but admittedly inaccurate – assumption of simple random sampling. The complex design and the post-stratification of the SHIW sample make it difficult to derive analytical expressions for standard errors. The further approximation implied by the use of asymptotic formulae is less problematic in consideration of the large size of the SHIW. For instance, Mills and Zandvakili (1997) found that, with a sample of around 4,000 units, the asymptotic and bootstrap estimates of the standard error for the Gini index were virtually the same. The asymptotic standard errors are calculated according to the formula derived by Cowell (1989), assuming known mean of sample weights.

verify this hypothesis, we calculate the synthetic index of polarisation proposed by Wolfson (1994) for the distribution of equivalent income among persons. This index was designed in the context of the late 1980s debate in the United States on the “shrinking middle class” with the purpose of measuring how the distribution is “spreading out” from the middle.<sup>7</sup> As inequality, polarisation rose sharply between 1991 and 1993; unlike inequality, however, it declined in the following nine years (Table 1). Thus, there is no evidence of a disappearing middle class, at least as measured on income by Wolfson index.

### 2.3 Financial poverty

A person is classed as poor if his/her household’s equivalent disposable income falls below the poverty line.<sup>8</sup> There are two alternative ways of setting the poverty line. On an *absolute* basis poverty is seen as the lack of the resources needed to purchase a minimum bundle of goods necessary for survival, where there is some leeway in the definition of what is necessary. On a *relative* basis poverty is regarded as the failure to achieve an adequate standard of living fixed with reference to the average standard of the community. We use both notions.

The absolute threshold is taken to coincide with the absolute standard defined by Istat (2002a). It corresponds to the cost of a minimum bundle of goods, which varies with household size and comprises four type of expenses: food, housing, service of durable goods, and a residual component. The cost of this bundle was analytically computed for 1997 and is annually updated by Istat for the variation in the CPI. For consistency with the other estimates, unlike Istat we obtain the value for 2003, our base year, by using the HED. Relative poverty lines are typically defined as some fraction of mean or median equivalent disposable income. To appreciate the sensitivity of results to the income level where we draw the line, we use two thresholds set at 50 and 60 per cent of the median, respectively. As shown in Table 1, the absolute line for a person living alone is constant at 400 euros per

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<sup>7</sup> The Wolfson index is equal to  $P=2(1-2\lambda-G)\mu/m$ , where  $\lambda$ ,  $G$ ,  $\mu$  and  $m$  are the income share of the bottom half, the Gini index, the mean and the median of the distribution, respectively. It ranges from zero (perfect equality) to one (perfectly bimodal distribution with half of the population at zero and the other half at  $2\mu$ ).

<sup>8</sup> In Italy official estimates of poverty have traditionally been based on consumption. In this paper, we focus on income and use the terms “poor” and “low-income” interchangeably. Unlike expenditure, household income measures the purchasing capacity regardless of households’ consumption choices and lifestyle.

month at the constant prices of 2003. The two relative lines reflect the movements of median real household income: a fall between 1991 and 1995 and then a rise from 1995 to 2002. In 2002 the line at 50 per cent of the median was 588 euros per month and that at 60 per cent was 706 euros, or 47 and 77 per cent higher than the absolute line, respectively.

The extent of poverty is measured by the headcount ratio, i.e. the share of population falling below the poverty line. Between 1991 and 1993 poverty rose abruptly according to all definitions, by 4-5 percentage points (Chart 9). In the following nine years, relative poverty has instead remained very stable: using the half-median line, it oscillated between 13 and 14 per cent; with the higher line, it stayed at around 20 per cent. By contrast, absolute poverty kept rising, if slightly, up to 1995 and it has fallen steadily afterwards to 8 per cent in 2002. If we compare the headcount ratios in 2002 with those in 1993, we observe that poverty decreased by 0.6 percentage points with the lower relative line, 0.9 points with the higher relative line and by 1.6 points with the absolute line.

[Chart 9 here]

#### *2.4 Summary*

To sum up, income inequality and financial poverty went up considerably between 1991 and 1993, at the time of the most severe recession experienced by Italy after the Second World War. On the other hand, there is no evidence of a rise of income inequality from 1993 to 2002, except for a modest transfer from the upper middle class to the richest 1 per cent of the population. This is shown by the analysis of movements across the entire distribution as well as by summary inequality measures like the Gini index and the quintile ratio. If identified with the share of low-income persons, also poverty does not appear to have been rising over the period 1993-2002 nor in the more recent period 2000-2002. It may even look falling if we adopt an absolute standard. These results may appear surprising in the light of the many changes that affected the Italian economy in the last decade, and they are at odds with the general public perception – even though we can not exclude, on the basis of the data at our disposal, that some changes occurred after 2002. The next Section will try to shed light on this puzzling evidence.



### 3. Why do Italians feel poorer – while they should not?

As discussed in Section 1, Italians feel that their economic condition has worsened both relative to the mid-1990s and compared with other European citizens. Yet, as seen in Section 2, the Italian income distribution has been remarkably stable since 1993 and there is no indication of an increase in the incidence of poverty. This section aims at reconciling the evidence on income distribution with the perceptions of citizens. We examine several possible explanations, from deficiencies in statistics to changes in the relative position of different social groups, from greater vulnerability induced by higher income mobility to disappointed expectations on aggregate economic growth.

#### 3.1 *Are there problems with the data?*

It is possible that the SHIW data that we have been using did not capture some important changes in the allocation of resources. Sample surveys are for their very same nature subject to measurement errors. They rely on the answers provided by households. Respondents may not remember all their household's sources of income and may find it difficult to estimate some of them, like earnings from self-employment or returns on stocks. Despite the efforts of interviewers, they may be reluctant to reveal to strangers personal information on sensitive issues such as income and wealth. Moreover, the measurement problems tend to be higher at the extremes of the income distribution, for the difficulty to include the very poor and the very rich in samples of limited size.

These shortcomings impinge on the measured levels of inequality and poverty. They can affect trends over time if the respondents' reporting behaviour or the survey design change significantly from one wave to the other, but we have no hint that this has happened. Furthermore, trends may be influenced by variations in the composition of total income when, as it is the case, the degree of under-reporting differs across income sources (see Brandolini, 1999). We check this hypothesis separately for capital income and earnings from self-employment. Using adjusted figures for capital income as estimated by Brandolini et al. (2004),<sup>9</sup> the rise of the Gini index from 1993 to 1998 and its fall from 1998 to 2002 are

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<sup>9</sup> Brandolini et al. (2004) apply several statistical methods to correct for non-response, non-reporting and under-reporting of real and financial wealth. These corrections affect also some income components, namely

amplified, but still statistically insignificant; the proportion of persons with equivalent income below 50 per cent of the median shows a moderately declining tendency since 1993 (Chart 10, left panels). As regards earnings from self-employment, we make use of the estimates by Cannari and Violi (1995). Under the assumptions that all households have the same expenditure function for food and that labour income is declared in full by employed heads of household and in part by self-employed ones, they recovered the relationship between true and reported income from self-employment and estimated an average under-reporting of about 20 per cent in 1989. We recalculated the Gini indices and the low-income ratios for all waves in the period 1993-2002 both after increasing all self-employment income by this average under-reporting and after adjusting them according to the relationship estimated by Cannari and Violi:<sup>10</sup> levels do not change much with the former adjustment but increase noticeably with the latter; trends are hardly affected (Chart 10, right panels).

[Chart 10 here]

A second way to validate our findings is to integrate the SHIW information with that provided by other sources. The only alternative source on household incomes is the Italian section of the ECHP, that covers income received in the period 1993-1999. According to these data, the Gini index *fell* from 33 to 29 per cent, a statistically significant drop (Brandolini, 2004). The levelling of the distribution was caused by the growth in the income shares of the bottom 60 per cent of the population at the expense of the remaining 40 per cent. The poorest fifth gained 1.2 percentage points, while the richest fifth lost 2.5 percentage points. The headcount poverty ratio declined from 14 to 12 per cent. This narrowing of the income distribution is at variance with the stationary tendency exhibited by the SHIW data. There are reasons to attach less weight to the ECHP than the SHIW estimates,<sup>11</sup> but what

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rents on dwellings different from the residence house, and interest and dividends (which in the SHIW are obtained by applying an average rate of return to the stock of each asset held by the household).

<sup>10</sup> Cannari and Violi (1995) modelled under-reporting by a double-logarithmic linear relationship. Using the results of their second model, the true earnings from self-employment are equal to  $0.009y^{1.46}$ , where  $y$  denotes reported earnings (the multiplicative coefficient has been recalculated to account for price changes between 1989 and 2003, our base year, and for the change from lire to euros). Notice that this adjustment implies that self-employment incomes are under-reported above 26,400 euros and over-reported below that threshold.

<sup>11</sup> As discussed in Brandolini (2004), panel attrition and non-inclusion of immigrants might have increasingly undermined the representativeness of the ECHP. However, it is the structure of the questionnaire that is likely to have mattered most: part of the fall in the ECHP Gini index between 1995 and 1998 might have been caused by an increased underestimation of incomes from capital and self-employment.

matters here is that the ECHP evidence suggests a fall in both income inequality and poverty which appears to be in even starker contrast to public perception.

Another source on distributive trends is the Survey of Household Budgets (SHB) conducted by Istat. The SHB provides detailed information on consumption expenditure which is used to estimate poverty figures. The values of the headcount ratio and the poverty gap – another poverty index which measures the average percentage shortfall from the poverty line of the household expenditure – for the period 1993-2003 are collected in Table 2. In addition to being based on expenditure rather than income, they differ from our poverty estimates for the definition of the indigence threshold, the equivalence scale, and the fact that they refer to households. Overall, the SHB figures suggest no increase in poverty from the mid-1990s to 2003.

[Table 2 here]

In brief, neither our robustness exercises on the SHIW data, nor the evidence from the two main alternative sources to the SHIW support the conclusion that inequality and poverty have been rising among Italian households in the last ten years.

### 3.2 *Horizontal income redistribution*

The analysis so far has focused on the “vertical” distribution between the rich and the poor, that is among persons who only differ in terms of their household’s equivalent income. Nothing has been said about modifications in the “horizontal” allocation of income across socio-demographic groups: significant movements along these dimensions may go along with the stability of the aggregate picture if they offset each other. Insofar as evaluations of the personal income situation are formed taking as reference other social groups, even modest changes in the horizontal distribution may entail substantial downward revisions for those belonging to the group experiencing a relative deterioration of its income position.

The investigation of homogenous population groups reveals important changes, in the last ten years, in the distribution of income among social groups as defined by the occupational status of the household’s head.<sup>12</sup> The distribution shifted to the advantage of the

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<sup>12</sup> The head is identified with the person in the household with the highest income from labour or pension. The importance of separating the population according to the occupational status of the household’s head to explain the cyclical evolution of inequality in Italy was underlined by Brandolini and Sestito (1994).

households of self-employed, managers (both public and private) and retired persons, and to the disadvantage of the households of production and clerical workers (including school teachers). Between 1993 and 2002 the real equivalent disposable income increased by 1.6-1.7 per cent per year for the former groups and by only 0.1-0.3 per cent for the latter (Table 3). As a result, the share of total equivalent income accruing to persons living in households headed by a blue- or white-collar diminished more than their proportion in total population, whereas the opposite happened for persons living in households headed by a self-employed, a manager or a pensioner; for persons living in households with a non-employed non-retired head the increase in income share was lower than that in the population share.

[Table 3 here]

These different income dynamics had an impact on group specific poverty ratios. Using the relative line at 50 per cent of the median, the incidence of low-income rose among households of production workers as well as of clerical workers (even if on much lower levels for the latter); it fell among households of retired heads and, above all, of the self-employed; it remained nil for those headed by managers; it stayed, unsurprisingly, on extremely high values among the remaining group of persons living in jobless households without pensioners (Table 4). Looking at absolute poverty, there was little change over the period 1993-2002 for the households of non-managerial employees and a clear improvement for those of the retired and the self-employed.

[Table 4 here]

These shifts are sizeable, yet they do not show up in national measures of poverty and inequality. It is instructive to decompose these measures to see how this happened. The headcount poverty ratio can be written as  $H = \sum_k p_k H_k$ , so that the contribution to total poverty of group  $k$  is equal to the product of its population share  $p_k$  and its specific headcount ratio  $H_k$ . Chart 11 shows the results of this decomposition. Between 1993 and 2002 the increase in relative poverty among households of production and clerical workers and of non-employed non-retired heads was more than compensated by the improved condition of the households of the retired and the self-employed, causing a slight decline of the general index by 0.6 percentage points. Likewise, the latter groups account for the whole reduction of the index of absolute poverty by 1.6 percentage points. The composition of the poor population changed accordingly (Chart 12).

[Chart 11 here]

[Chart 12 here]

With regards to inequality, we can decompose the Gini index  $G$  according to the formula  $G = G_W + G_B + R = \sum_k p_k q_k G_k + G_B + R$ , where  $k=1, \dots, 6$  denotes the six social groups in which we have divided the population (Lambert and Aronson, 1993).  $G_W$  is the within-groups inequality, i.e. the weighted average of the within-group Gini indices  $G_k$ 's, with weights given by the product of the population share  $p_k$  and the income share  $q_k$  of each group  $k$ .  $G_B$  is the between-groups Gini index, i.e. the one which would obtain if every person in group  $k$  received the income mean of group  $k$ .  $R$  is a residual term capturing the degree of “overlapping” between the income distributions of the six social groups, which equals 0 when the richest in each group is poorer than the poorest in the next group. The results of the decomposition are reported in Table 5. From 1993 to 2002 the inequality within social groups holds steady, but the increasing distance among groups would have caused the Gini index to rise by 1.1 percentage points, were it not offset by a decline in the overlapping term.

[Table 5 here]

The decomposition by population groups identified on the basis of the household's head occupational status has confirmed the conjecture that offsetting movements more than an immobile situation lie behind the apparent stability of aggregate inequality and poverty indices. Decompositions by other household characteristics are also revealing but do not exhibit the same sharp contrast as the occupational status. For instance, fixing the line at 50 per cent of the (national) median, between 1993 and 2002 the headcount poverty ratio diminished in the North and slightly rose in the South; but it fell more in the South than in the North when the absolute line is used. However suggestive, the extent to which the recent sense of household impoverishment can be traced back to the distributive patterns discussed in this Section remains an open issue.

### *3.3 Household vulnerability: income mobility patterns and social insurance*

There is a third distributive dimension that deserves attention: income dynamics. If households are risk averse and real incomes are stagnant, greater income volatility may induce an overall decline in well-being. Household impoverishment is hence to be understood as a

growing risk of destitution more than as an actual increase in the proportion of persons below the poverty line. But has income volatility actually increased?

The SHIW has a panel section that allows us to describe mobility across percentiles of the income distribution at a distance of two years. (As in our previous calculations, in a given year each person is assigned the equivalent income of the household where he or she lives.) We perform two different comparisons. First, we contrast the situation at the beginning of the current decade (2000-02) with that in the aftermath of the recession of the early 1990s (1993-95). Second, we compare the Italian mobility pattern with that prevailing in Great Britain at the beginning of the 1990s (1991-93) by drawing on findings by Jarvis and Jenkins (1998). The British figures are broadly comparable in terms of income definition, but differ from our estimates because they are derived by applying a different equivalent scale, and income refers to the month (or relevant period) prior to the interview rather than the previous calendar year.

Table 6 reports a few indicators of income immobility. The first line contains Pearson correlation coefficient between each person's income levels in two subsequent waves: the closer is the coefficient to 1, the greater is income immobility. The next six lines have measures of the permanence of people in a given income group of the population ranked by increasing income, and in that group or a neighbouring one. These groups are identified in relative terms by deciles and quintiles, and in absolute terms, by cut-offs set at 0.5, 0.75, 1.0, 1.25 and 1.5 times the mean income in the initial year. Instead of indicators of immobility, the last two lines report the values for the index of mobility proposed by Shorrocks (1978). It is defined as  $M = [S - tr(P)] / (S - 1)$ , where  $S$  is the number of income cells (5 and 10 in our case) and  $tr(P)$  is the trace of the mobility matrix  $P$ . Shorrocks' measure concentrates on the "stayer" coefficients, i.e. the numbers displayed along the diagonal of the matrix  $P$ , denoting the probability of remaining over time in the same income group. The index  $M$  takes value zero when there is perfect immobility, i.e. the probability of *not* changing income group equals one in any group ( $P$  is the identity matrix); it is equal to one when there is perfect mobility, i.e. the probability of ending up in any group is independent of the initial group ( $P$  has identical rows). All different indicators reported in Table 6 consistently point to a noticeable increase of income mobility in Italy from 1993-95 to 2000-02. Because of these changes, the Italian income mobility pattern has become more similar to that characterising Great Britain at the beginning of the 1990s.

[Table 6 here]

The full mobility matrices underlying the summary measures just discussed are reported in Tables 7 and 8. Each entry gives the fraction of persons originally in the group indicated in row who have moved after two years to the group indicated in column. Thus, 69 in the top left-hand corner of Table 7 means that 69 per cent of persons in the bottom fifth of the income distribution in 1993 were still in the bottom fifth two years later, while 21 per cent had moved to the next quintile group, and so forth. By definition, the entries of each line add up to 100. Few observations are in order. First, immobility has fallen from 1993-95 to 2000-02 throughout the distribution, as all terms along the main diagonal decreased. Second, both mobility upwards in the poorest group and mobility downwards in the richest group increased considerably, but movements tended to head towards relatively nearer groups. Third, in the second quintile group the increase in mobility has taken the form of a higher risk of moving down the income ladder: the probability of falling to the bottom quintile group increased by 6 percentage points, from 20 to 26 per cent. Fourth, this greater downward mobility is relative, not absolute. By virtue of the growth or real income in the 2000-02 period, absolute downward mobility tended to diminish for most income groups (Table 8).

[Table 7 here]

[Table 8 here]

These figures give us the picture of a country where household incomes have become more mobile from one year to the next. The analysis of the causes of this change is beyond the scope of this paper. Here, it suffices to mention two factors: the spreading of risky assets in household portfolios, and the lower job security. According to the SHIW data, between 1989 and 2002 the share of private bonds, equities, and mutual funds increased from 3 to 13 per cent of net worth; the holding of risky assets increased also among relatively low-income households (Brandolini et al., 2004). This growing importance of risky assets is likely to have increased the perception of uncertainty and wealth mobility itself. As to the labour market, the share of fixed-term jobs in total dependent employment increased markedly from 1995 to 2000, remaining around 10 per cent thereafter, according to the Labour Force Survey (Chart 13). This tendency was accompanied by a fall in the probability of transition from fixed-term to permanent positions, only temporarily interrupted around 2001 by favourable cyclical conditions and a generous subsidy for permanent hires (see Cipollone and Guelfi, 2003).

Moreover, fixed-term employees suffer a higher risk of becoming unemployed than permanent employees: in 2002-03 the probability of entering unemployment was 7.6 per cent for the former and 2.3 per cent for the latter. These facts help to explain the finding of a survey carried out by Fondazione Rodolfo De Benedetti in April 2002 that about 70 per cent of Italians prefer a rigid “labour market in which jobs are difficult to find but last longer” to a flexible “labour market regime in which it is relatively easy to find a job, but it is likewise easy to lose a job”.<sup>13</sup> These preferences change significantly when job losers receive unemployment benefits and some assistance in job search. This suggests that the costs of uncertainty may decrease significantly when social insurance against job loss and, more broadly, income fluctuations is offered.

[Chart 13]

The last observation brings us to the inadequacy of the Italian welfare state. It is well-known, for instance, that unemployment benefits in Italy have the lowest coverage among EU countries. According to ECHP data, taking the average over the period 1994-2001, only 17 per cent of the Italians who were unemployed at the time of the interview and had lost their job in the previous 12 months reported to receive unemployment benefits, compared with twice as many in Greece and Portugal, and over 80 per cent in Austria, Belgium, Denmark, Finland and Germany (Chart 14).

[Chart 14 here]

More generally, Italy is among the EU country where the redistribution from the top to the bottom of the income distribution is lowest. This can be seen by drawing on the micro-simulation results of the EUROMOD (2004a, 2004b) project. In 2001 the income share of the poor, i.e. the persons with disposable equivalent income lower than 60 per cent of the median, rose from 4.5 to 7.0 per cent after adding public transfers to and deducting direct taxes from original income; in all other EU countries, except Luxembourg, this difference was larger (Table 9). (Notice that the size of the income share of the poor reflects the level of the headcount ratio: the higher the poverty rate, the larger the share.) This result derives not only from the low level of social expenditure (other than pensions), but also from the modest

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<sup>13</sup> The survey was conducted on a representative sample of 1,000 persons aged 16 to 80. Boeri, Conde-Ruiz and Galasso (2003) show that the probability of being in favour of a rigid labour market increases with age and decreases with educational attainment; it is lower for those who have lost a job or live in the South.



targeting properties of the Italian welfare system (Rostagno and Utili, 1998; Boeri and Perotti, 2002). Lastly, the Italian tax system contributes mildly to reducing income inequality. This is shown in the last three columns of Table 9, also from the EUROMOD project (Verbist, 2004), by the relatively small difference between the Gini index for income before taxes and the Gini index for income after taxes.

[Table 9 here]

### *3.4 Macroeconomic context and disappointed expectations*

There is another set of issues that can be at the roots of the sentiment of household impoverishment. As well known, the Italian economy has been growing at a slow pace in the last decade – originating an intense debate on the risk of “economic decline” of the country (e.g. Ciocca, 2003; Faini, 2003; Nardozi, 2004; Rossi, 2004). On average, real GDP rose by 1.7 per cent per year from 1994 to 2003, and just by 0.3 per cent in the last two years; it had grown by 2.3 per cent per year from 1983 to 1992. This weak growth has had repercussions on the labour market. The unemployment rate was over 10 per cent from 1993 to 2000 and it was still above 8 per cent in 2003. Job creation was largely sustained by the spread of part-time positions, temporary jobs, contingent work and other non-typical forms of employment, and went along with a rise of low-paid work (Brandolini, Cipollone and Sestito, 2002), which contributed to moderate wage dynamics. In 2003 gross wages and salaries per full-time equivalent employee were in real terms, using the HED, at the same level of ten years earlier. This stagnation of labour earnings compares to a cumulated growth of 13 per cent from 1983 to 1992, during the 1980s expansion (Chart 15, left-hand panel).

The behaviour of per capita wages and salaries accounts for only part of the evolution of household income. This depends on the number of people working in the household as well as on any other source of income. Indeed, household disposable income increased more than employees’ earnings: in per capita terms and at constant prices, the variation was by a total 8 per cent between 1993 and 2002. Nonetheless, there remains a considerable gap between the recent growth of real income and that in the 1980s, which was near to 30 per cent (Chart 15, right-hand panel).

[Chart 15 here]

If households' expectations on the medium-run growth of their incomes are formed, in part, on their past experience, the much slower dynamics of real output in the 1990s than in the 1980s might have brought about a general sense of impoverishment – which has then to be seen as a relative rather than absolute worsening. This pessimistic attitude has been probably reinforced by the fiscal consolidation of the 1990s, in particular the pension reforms, and the awareness that new severe measures are likely in the future. Public opinion polls indicate that a large majority of Italians believes that “in the course of the next ten years there will be another pension reform reducing significantly the amounts of public pensions” (Boeri, Boersch-Supan and Tabellini, 2002, p. 397).

The problem with this explanation is that the slowdown of growth has been manifest for years, including the 1980s if compared to the 1970s. Although revisions of expectations take some time to materialize and the disappointment of households' expectations on the dynamics of their income may have played some role, it can be hardly seen as a major factor behind the recent surge of concern for income distribution: the timing is basically wrong. Other factors might have driven the worsening of households perceptions in the last three years. For instance, Golinelli and Parigi (2004) suggest that the currency changeover may have triggered a sharp downward re-adjustment of the excessively optimistic expectations nurtured by households in the aftermath of the 2001 political election.

## **Conclusions**

Expressions like “new poverty”, “household impoverishment”, “crisis of the middle class”, “the wage issue” have featured prominently, if unusually, in the recent public debate in Italy. There are at least four diverse dimensions in this debate. The first is the *macroeconomic* dimension, which is summarised by the concern for the “economic decline” of the country, i.e. the failure to keep up with the pace of growth experienced in the past. A second dimension is represented by changes in the *distribution of economic resources* in the form of a rise in income inequality, of higher poverty, or a disappearing middle class. The third dimension is also distributive, but it has to do more with future risks than past changes: the focus is on the increased *economic vulnerability* of Italian households. The fourth dimension goes beyond

medium-run trends: it relates to *social mobility*, both intra- and inter-generational, and hints at a stiffening of social stratification. These different themes are intertwined, often confused, in the public debate. The aim of this paper has been to address some of these issues, and to provide concrete evidence on the discontent of Italian households.

As seen in Section 1, households perceptions about financial hardship and housing condition deteriorated since mid 1990s and, more recently, their expectations about economic prospects (both personal and of their own country) got significantly worse in Italy than in other EU countries, including those belonging to the EMU. On the other hand, on the basis of the SHIW evidence presented in Section 2, the inequality of disposable incomes rose sharply between 1991 and 1993 but did not increase thereafter. Likewise, headcount poverty ratios did not show any upward trend, following the dramatic worsening of the early 1990s: the relative measures remained stable, while the absolute ones declined. Note that these observations focus on the *evolution* of income inequality over time, but are silent on its *level*. The inequality of equivalent disposable income is in Italy among the highest in the European Union, as shown by the figures in Table 9, or by the most recent comparable statistics of the Luxembourg Income Study (2004).<sup>14</sup>

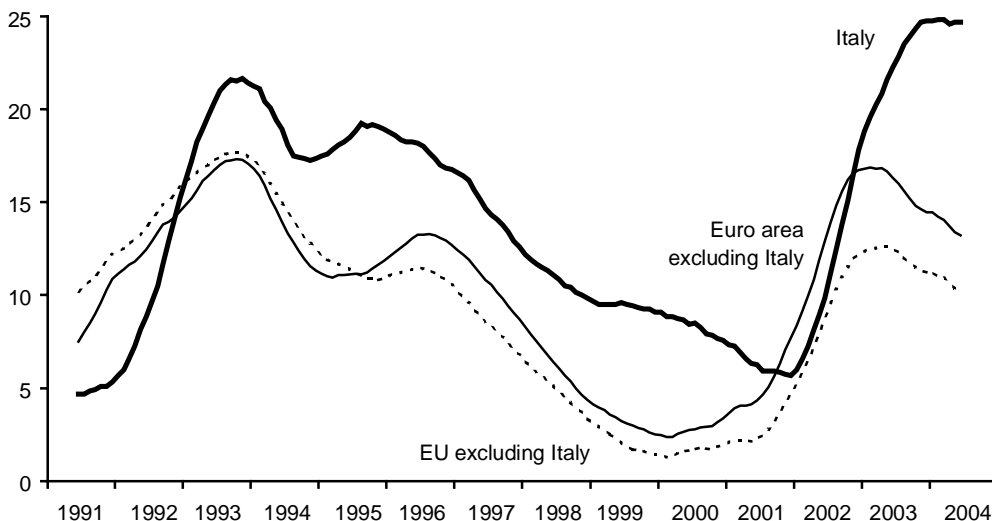
How can “negative perceptions” and “declining expectations” be reconciled with a basic stability of the income distribution? We reviewed few potential explanations for this apparent puzzle. The first relates to measurement problems. Alternative data sources to the SHIW, however, display a constancy or even a decline in poverty rates even when data cover up to 2003. Also adjustments to take into account unreported self-employed income or capital income do not point to a recent increase of income inequality and poverty. Another explanation is a story of disappointed expectations. The strong deceleration of income growth in the 1993-2003 period with respect to the previous decade jointly with fiscal consolidation and concerns about the long-term sustainability of public finance led Italians to drastically revise downwards expectations of income growth. The third explanation has to do with changes in the distribution of income across social groups defined on the basis of the labour market status of the household head: employees suffered a marked deterioration of their

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<sup>14</sup> Data refer to 1999 or 2000 depending on the country. The Gini index of Italy (33 per cent) is above those of Finland, Germany, Norway, the Netherlands, Slovenia and Sweden (25 per cent), Luxembourg (26 per cent), Poland and Hungary (29 per cent), and Canada (30 per cent); it is below those of the United Kingdom (35 per cent) and the United States (37 per cent).

incomes vis-à-vis the self-employed and this was reflected by a widening gap in the perceptions of these two groups. The fourth explanation concentrates on the rise in income mobility experimented in the last ten years, both in relative and absolute terms. Here the reasoning is tentative, but increased job precariousness and income fluctuations associated with the holding of risky assets may have tuned down the perceived benefits of the decline in unemployment. Under stagnating incomes and risk aversion, greater uncertainty is likely to have reduced the well-being of individuals. These tendencies have made even more visible well-known deficiencies of our social protection system, such as the low coverage of unemployment benefits or its poor targeting properties in comparison with other European countries. None of these factors provides, by itself, a complete explanation. Taken together, however, they suggest an ongoing deep transformation of the Italian society – which is at the roots of the households' discontent.

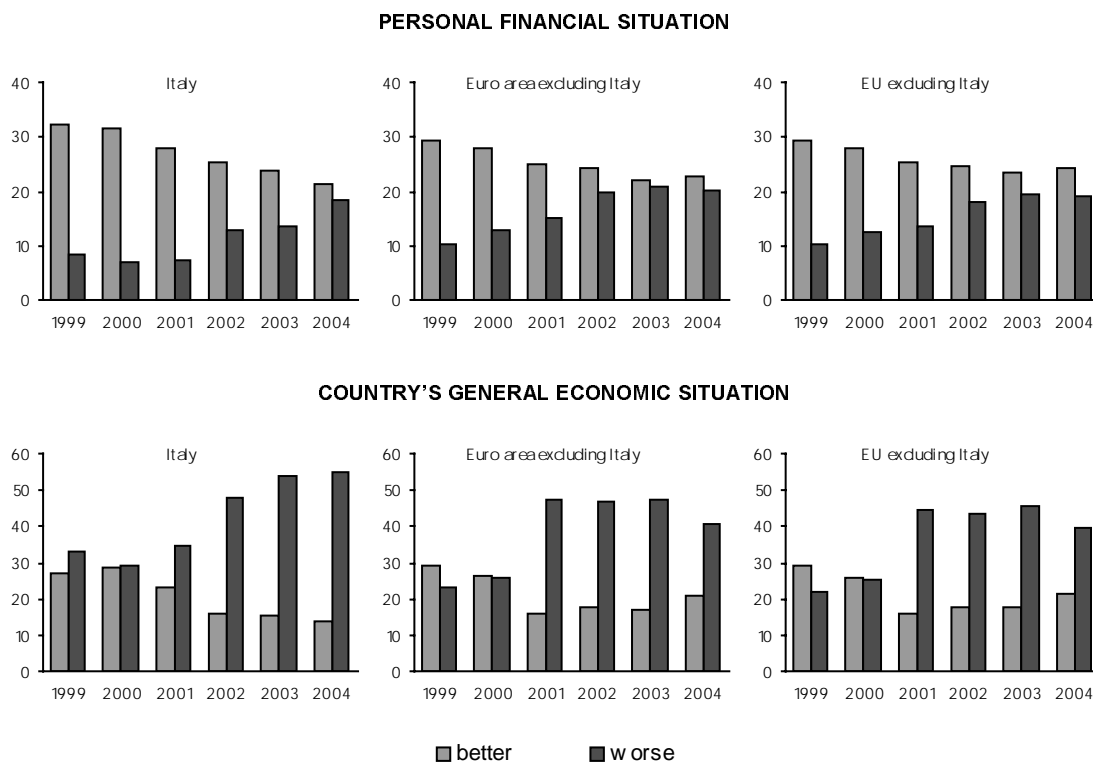
**WORSENING OF THE REPORTED HOUSEHOLD FINANCIAL SITUATION**  
 (12-terms centred moving average)



Source: authors' calculations on data from European Commission, BCS. Each series represents the weighted balance between the percentage of respondents declaring that their household's financial situation got worse in the previous 12 months and the percentage of respondents declaring that their household's financial situation improved. The weights of answers "a lot worse/better" are twice the weights of answers "a little worse/better". The aggregate series for the euro area and the EU, both excluding Italy, are calculated as weighted average of national balances, using the country's share in total population as weight.

Chart 2

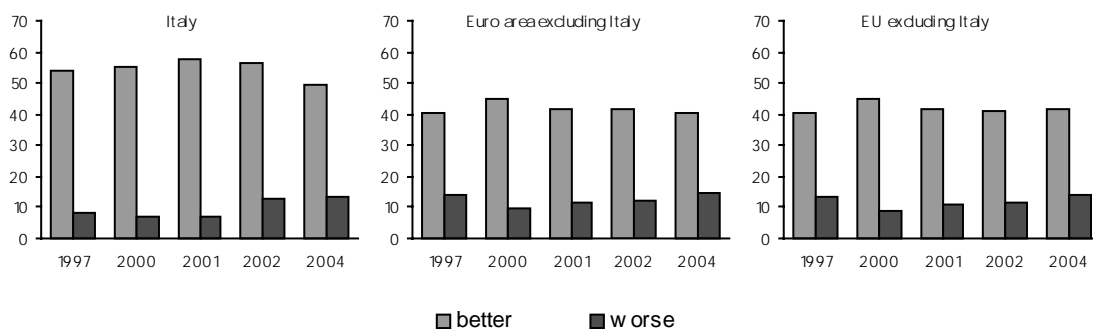
**EXPECTATIONS ON PERSONAL AND COUNTRY'S SITUATIONS IN NEXT YEAR**  
(percentage share of valid answers)



Source: authors' calculations on microdata from Eurobarometer.

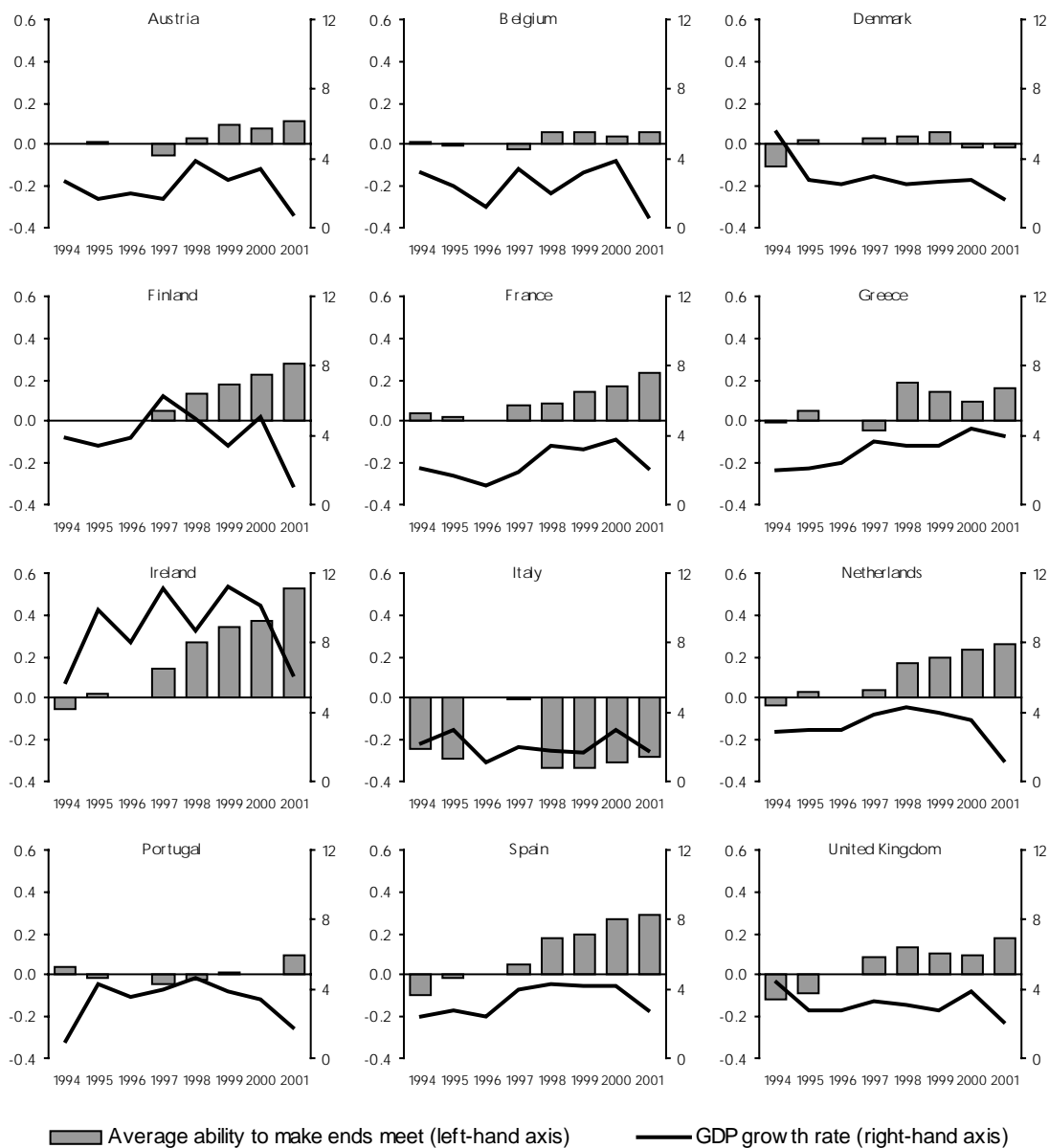
Chart 3

**EXPECTATIONS ON PERSONAL FINANCIAL SITUATION IN NEXT FIVE YEARS**  
(percentage share of valid answers)



Source: authors' calculations on microdata from Eurobarometer.

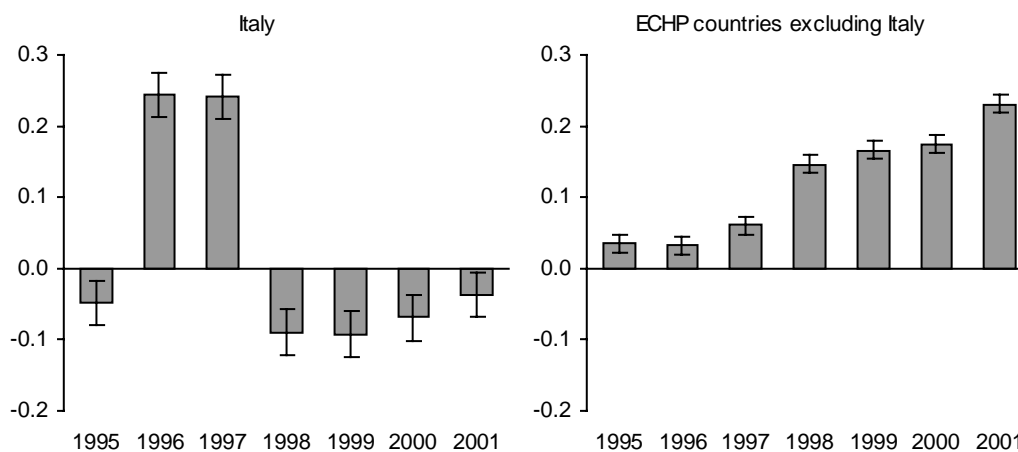
**CHANGE IN PERCEIVED ABILITY TO MAKE ENDS MEET IN EU COUNTRIES**  
 (absolute deviation from average score in 1996 and per cent)



Source: authors' calculations on microdata from the ECHP. Scale: 1=great difficulty, ..., 6=very easily.

Chart 5

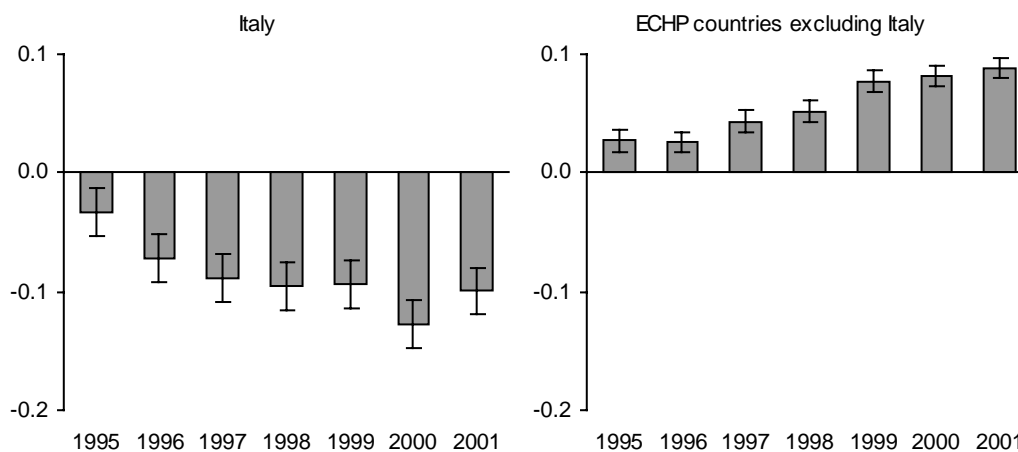
**REPORTED HOUSEHOLD ABILITY TO MAKE ENDS MEET**  
(panel estimates of yearly dummies, 1994-2001)



Source: authors' calculations on microdata from the ECHP. Scale: 1=great difficulty, ..., 6=very easily. ECHP countries include Austria (1995-2001), Belgium, Denmark, Finland (1996-2001), France, Greece, Ireland, the Netherlands, Portugal, Spain and the United Kingdom.

Chart 6

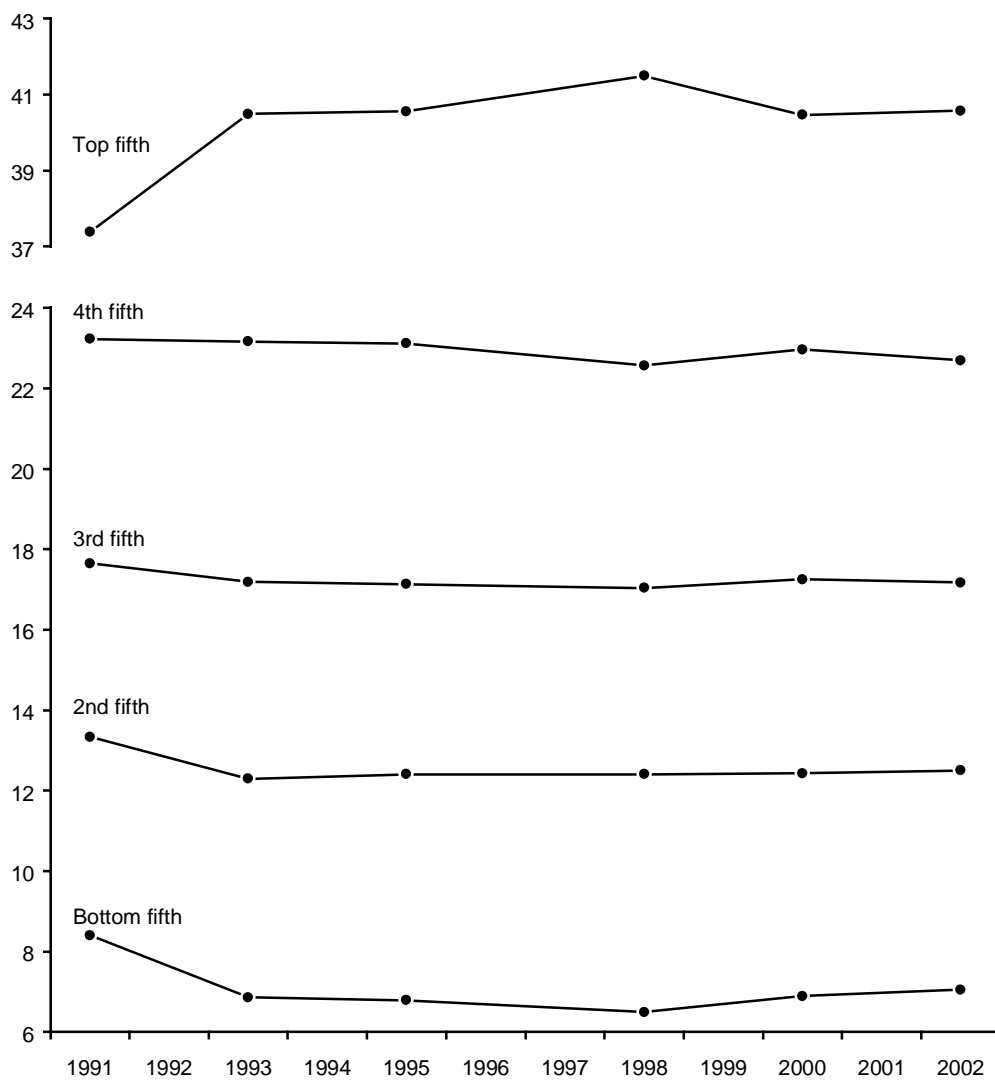
**REPORTED HOUSEHOLD HOUSING COST SITUATION**  
(panel estimates of yearly dummies, 1994-2001)



Source: authors' calculations on microdata from the ECHP. Scale: 1=a heavy burden, 2=somewhat a burden, 3=not a problem. ECHP countries include Austria (1995-2001), Belgium, Denmark, Finland (1996-2001), France, Greece, Ireland, the Netherlands, Portugal, Spain and the United Kingdom.

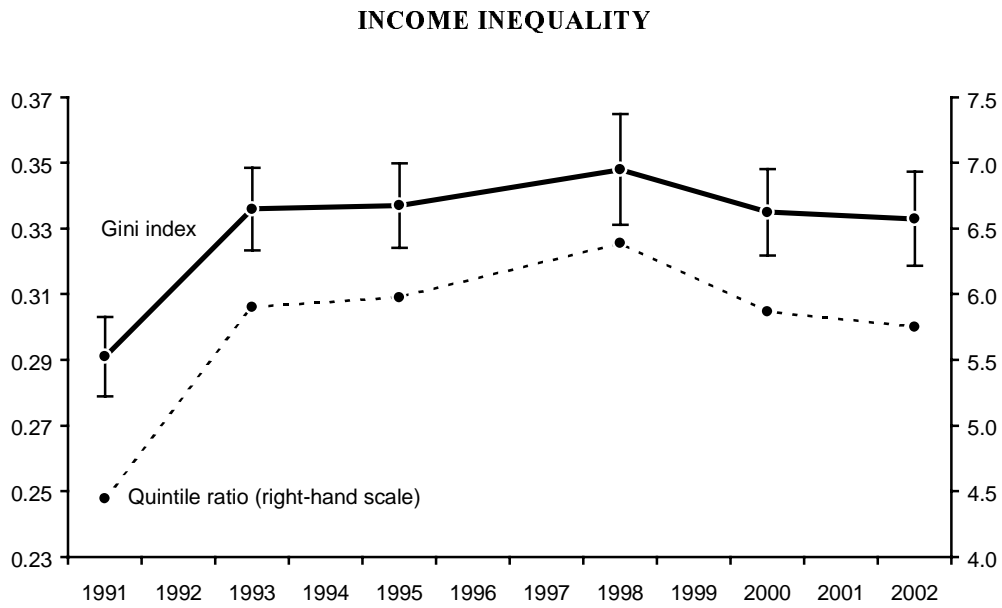


**INCOME SHARES OF POPULATION FIFTHS**  
(per cent)



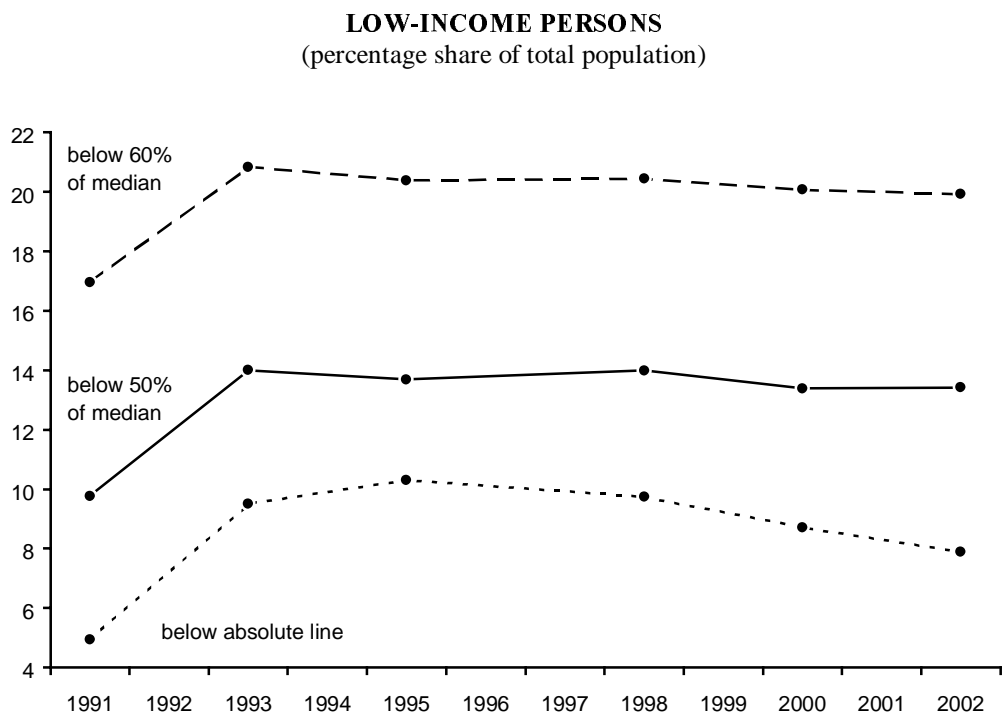
Source: authors' calculations on data from the SHIW-HA (Version 3.0).

Chart 8



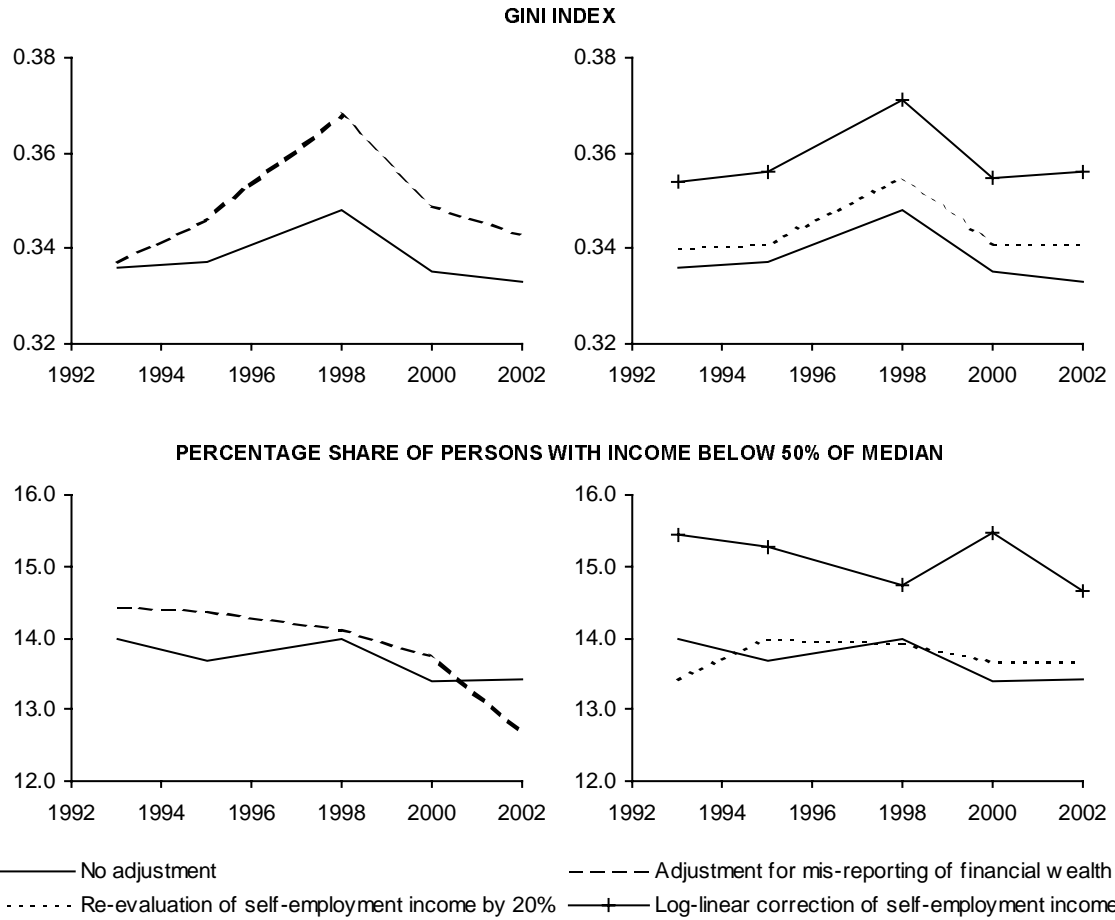
Source: authors' calculations on data from the SHIW-HA (Version 3.0). Vertical bars equal twice the standard error on both sides of the point estimate.

Chart 9



Source: authors' calculations on data from the SHIW-HA (Version 3.0).

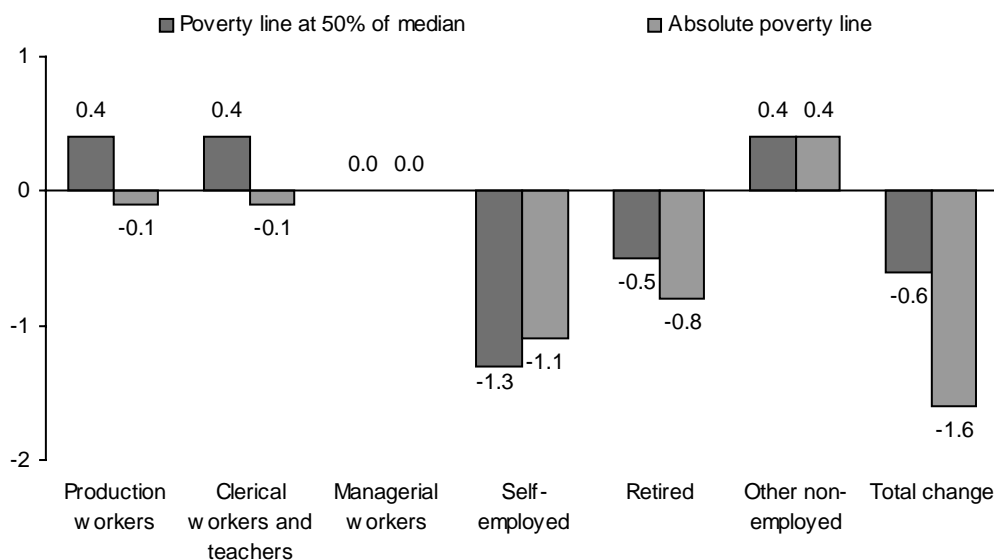
**IMPACT ON INEQUALITY AND POVERTY OF ADJUSTMENTS FOR MIS-REPORTING OF INCOMES**



Source: authors' calculations on data from the SHIW-HA (Version 3.0). See text for details on adjustments.

Chart 11

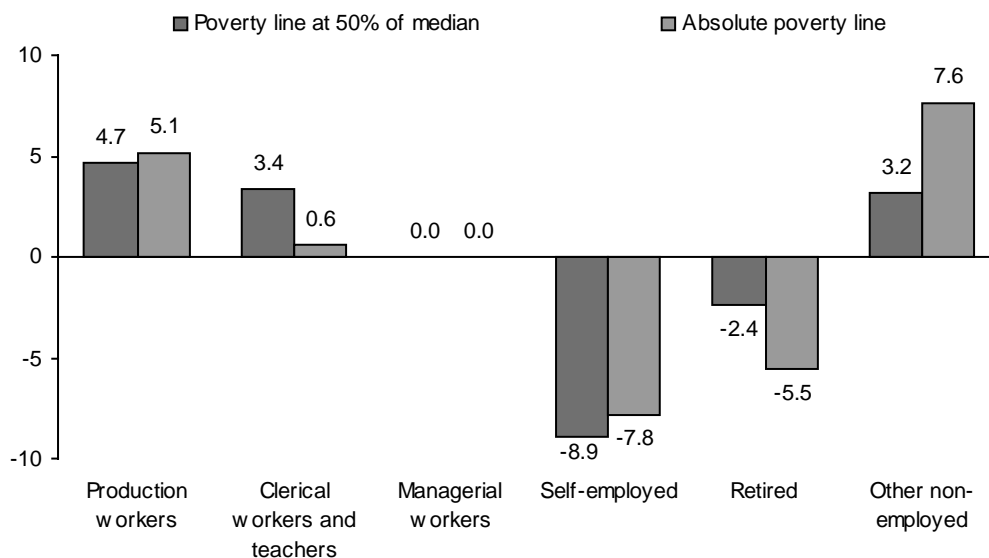
**DECOMPOSITION OF THE HEADCOUNT POVERTY RATIOS BY SOCIAL GROUP**  
(percentage points)



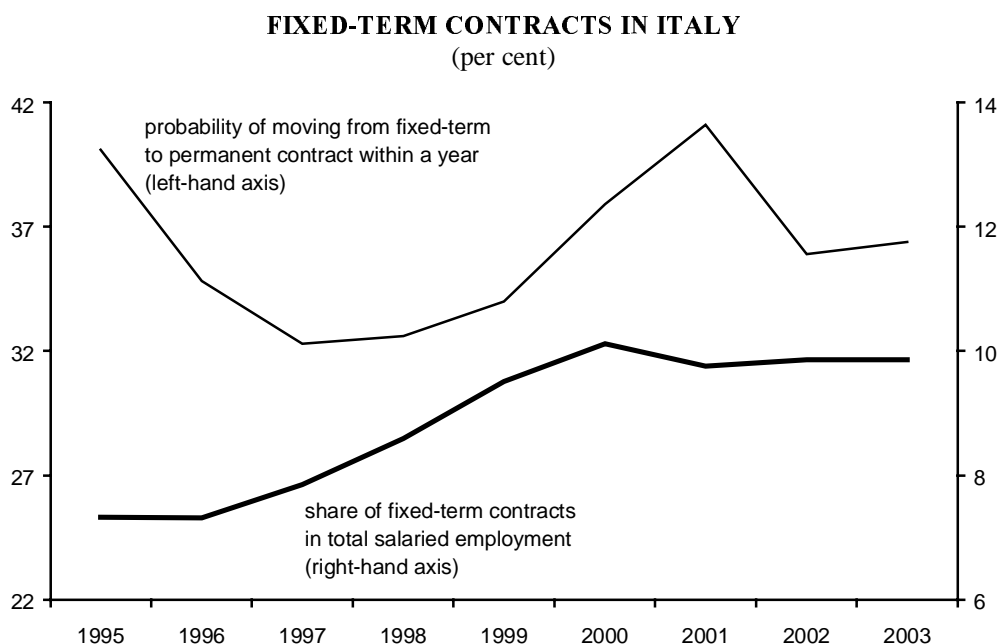
Source: authors' calculations on data from the SHIW-HA (Version 3.0). The social group is defined by the labour market status of the household's head.

Chart 12

**CHANGE IN THE COMPOSITION OF THE POOR BY SOCIAL GROUP**  
(percentage points)

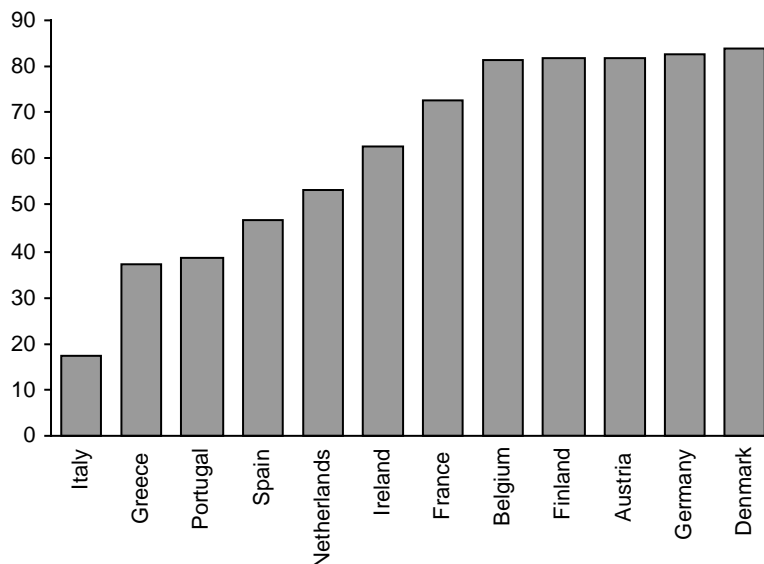


Source: authors' calculations on data from the SHIW-HA (Version 3.0). The social group is defined by the labour market status of the household's head.



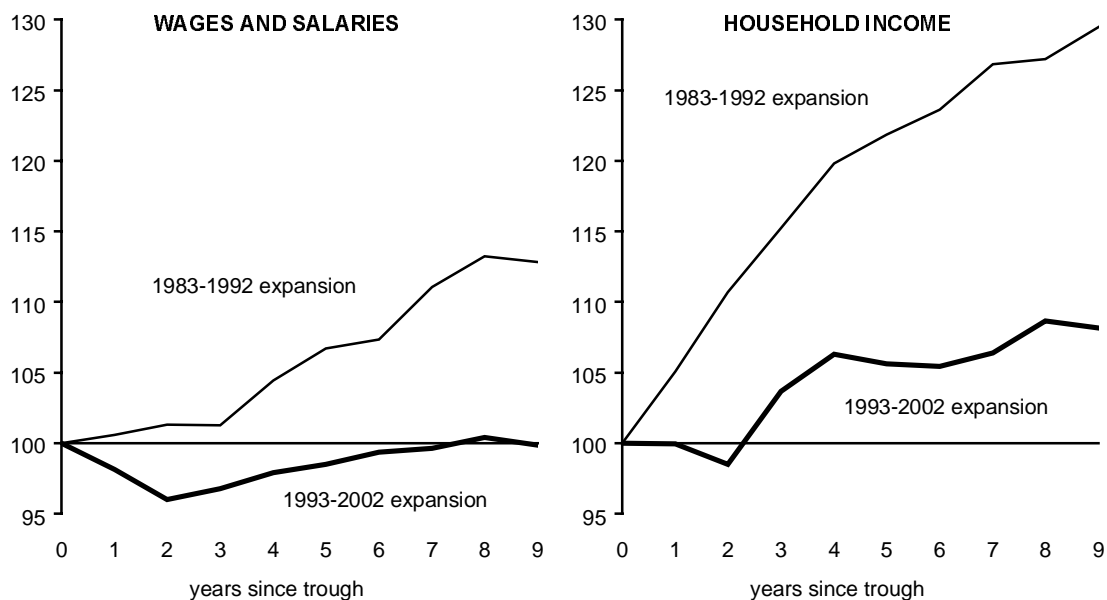
Source: Istat, Labour Force Survey. Transitions are computed from April to April. Fixed-term and permanent contracts refer to all employees (both full-time and part-time).

**COVERAGE OF UNEMPLOYMENT BENEFITS IN CASE OF JOB LOSS IN EU COUNTRIES**  
(per cent)



Source: authors' calculations on microdata from the ECHP. Share of persons declaring to have lost their job in the 12 months before the interview who state to be covered by unemployment benefits. Average for the period 1994-2001, except for Austria (1995-2001), Finland (1996-2001) and France (1994-1999).

**PER CAPITA WAGES AND SALARIES AND HOUSEHOLD INCOME  
IN THE LAST TWO EXPANSIONS**  
(index = 100 in trough year)



Source: authors' calculations on Istat data. Per capita wages and salaries are obtained by dividing total wages and salaries in national accounts by the number of full-time equivalent employed units. Per capita household income is equal to the disposable income of the household sector, net of depreciation and capital losses on households' wealth holdings due to inflation, divided by total population; the series for net disposable income is derived from Istat (2002b, 2004b); the series for households' wealth holdings includes cash, bank and postal accounts, and private and public bonds and it is drawn from Brandolini et al. (2004), table A1, p. 45.

Table 1

**DISTRIBUTION OF REAL MONTHLY EQUIVALENT INCOME**  
(euros at 2003 prices and per cent)

Statistic	1991	1993	1995	1998	2000	2002
Mean	1,301	1,256	1,232	1,309	1,326	1,365
Percentiles						
5th	474	332	327	318	356	393
10th	577	470	454	460	493	526
20th	733	634	623	660	682	707
30th	871	768	765	816	818	855
40th	1,004	910	899	964	982	1,007
50th (median)	1,147	1,075	1,048	1,112	1,138	1,177
60th	1,310	1,254	1,221	1,286	1,312	1,336
70th	1,496	1,438	1,410	1,471	1,508	1,531
80th	1,748	1,708	1,683	1,722	1,791	1,823
90th	2,161	2,218	2,111	2,219	2,244	2,352
95th	2,590	2,750	2,674	2,813	2,880	2,978
99th	3,806	4,438	4,414	5,162	4,618	4,884
Income shares						
Bottom tenth	3.3	2.4	2.4	2.1	2.4	2.5
2nd tenth	5.1	4.4	4.4	4.4	4.5	4.5
3rd tenth	6.1	5.6	5.7	5.6	5.6	5.7
4th tenth	7.2	6.7	6.8	6.8	6.8	6.8
5th tenth	8.2	7.9	7.9	7.9	8.0	8.0
6th tenth	9.4	9.3	9.2	9.1	9.3	9.2
7th tenth	10.8	10.7	10.6	10.5	10.6	10.4
8th tenth	12.4	12.5	12.5	12.1	12.4	12.3
9th tenth	14.8	15.3	15.1	14.8	15.0	15.1
Top tenth	22.6	25.1	25.5	26.7	25.5	25.5
Top 5 per cent	13.5	15.5	16.0	17.3	16.0	15.8
Top 1 per cent	4.3	4.8	5.2	6.4	5.4	5.2
Inequality measures						
Gini index (s.e.)	0.291 (0.0060)	0.336 (0.0063)	0.337 (0.0065)	0.348 (0.0084)	0.335 (0.0066)	0.333 (0.0071)
Quintile ratio	4.4	5.9	6.0	6.4	5.9	5.8
Polarisation measures						
Wolfson index	0.248	0.287	0.284	0.273	0.276	0.269
Poverty line						
at 50 per cent of median	574	537	524	556	569	588
at 60 per cent of median	688	645	629	667	683	706
absolute	400	400	400	400	400	400
Headcount poverty ratio						
line at 50 per cent of median	9.8	14.0	13.7	14.0	13.4	13.4
line at 60 per cent of median	17.0	20.8	20.4	20.4	20.1	19.9
absolute line	4.9	9.5	10.3	9.7	8.7	7.9

Source: authors' calculations on data from the SHIW-HA (Version 3.0). Figures may not add up to totals because of rounding.

Table 2

**POVERTY INDICES FOR HOUSEHOLDS**  
(per cent)

Year	Headcount ratio				Relative income gap				
	Base line		80% base line		120% base line		Absolute line		
1993	10.7		4.5		19.7			18	
1994	10.2		4.5		18.2			20.7	
1995	10.6		5.0		18.1			21.7	
1996	10.3		4.7		18.2			21.0	
1997	11.2	12.0	5.1	5.6	19.6	19.6	4.6	21.5	18.6
1998		11.8		5.7		19.6	4.5	22.4	20.0
1999		11.9		6.0		19.5	4.8	22.9	19.6
2000		12.3		6.0		20.6	4.3	22.5	19.3
2001		12.0		5.4		20.0	4.2	21.1	19.3
2002		11.0		5.1		19.0	4.2	21.4	19.6
2003		10.6		4.9		18.5	–	21.4	–

Source: Brandolini (2004), Table 7. Official estimates based on Istat's Survey of Household Budgets. The discontinuity in 1997 is due to an extensive methodological revision of the survey. Poverty estimates based on the absolute line have not been published for 2003.



Table 3

**DISTRIBUTION OF REAL MONTHLY EQUIVALENT INCOME BY SOCIAL GROUP**  
(euros at 2003 prices and per cent)

Statistic	1993	1995	1998	2000	2002	Absolute change 1993-2002
<b>Mean</b>						
Production workers	972	978	977	989	1,001	29
Clerical workers and teachers	1,480	1,459	1,413	1,467	1,492	12
Managerial workers	2,624	2,482	2,579	2,545	3,019	395
Self-employed	1,487	1,449	1,765	1,632	1,712	225
Retired	1,091	1,113	1,210	1,263	1,269	178
Other non-employed	467	386	521	533	487	20
Total	1,256	1,232	1,309	1,326	1,365	109
<b>Income share</b>						
Production workers	18.9	19.5	16.4	17.0	16.5	-2.4
Clerical workers and teachers	31.3	28.8	27.4	25.6	26.7	-4.6
Managerial workers	3.7	3.4	3.0	3.7	3.9	0.2
Self-employed	23.3	22.5	25.6	25.3	26.1	2.8
Retired	22.0	24.9	26.0	27.2	25.8	3.8
Other non-employed	0.8	0.9	1.6	1.2	1.0	0.2
Total	100.0	100.0	100.0	100.0	100.0	-
<b>Population share</b>						
Production workers	24.5	24.5	22.0	22.8	22.5	-2.0
Clerical workers and teachers	26.5	24.4	25.4	23.1	24.5	-2.0
Managerial workers	1.8	1.7	1.5	1.9	1.7	-0.1
Self-employed	19.7	19.1	19.0	20.6	20.8	1.1
Retired	25.3	27.6	28.1	28.5	27.8	2.5
Other non-employed	2.2	2.7	4.0	3.1	2.7	0.5
Total	100.0	100.0	100.0	100.0	100.0	-

Source: authors' calculations on data from the SHIW-HA (Version 3.0). The social group is defined by the labour market status of the household's head.

Table 4

**POVERTY STATISTICS BY SOCIAL GROUP**  
(per cent)

Statistic	1993	1995	1998	2000	2002	Absolute change 1993-2002
<i>Poverty line at 50 per cent of median</i>						
Headcount poverty ratio						
Production workers	17.1	16.4	18.6	18.6	20.5	3.4
Clerical workers and teachers	3.6	3.8	3.5	3.6	5.7	2.1
Managerial workers	0.0	0.0	0.0	1.3	0.0	0.0
Self-employed	18.6	15.1	11.8	12.1	11.1	-7.5
Retired	14.8	13.3	13.9	12.6	11.8	-3.0
Other non-employed	65.9	80.9	71.1	71.9	68.4	2.5
Total	14.0	13.7	14.0	13.4	13.4	-0.6
Composition of the poor						
Production workers	29.8	29.3	29.3	31.6	34.5	4.7
Clerical workers and teachers	6.9	6.7	6.4	6.2	10.3	3.4
Managerial workers	0.0	0.0	0.0	0.2	0.0	0.0
Self-employed	26.1	21.1	16.0	18.6	17.2	-8.9
Retired	26.8	26.8	27.8	27.0	24.4	-2.4
Other non-employed	10.4	16.1	20.5	16.4	13.6	3.2
Total	100.0	100.0	100.0	100.0	100.0	–
<i>Absolute poverty line</i>						
Headcount poverty ratio						
Production workers	12.2	12.8	14.5	12.4	12.8	0.6
Clerical workers and teachers	2.6	1.9	2.0	1.3	2.6	0.0
Managerial workers	0.0	0.0	0.0	1.3	0.0	0.0
Self-employed	13.0	13.2	8.1	9.4	7.2	-5.8
Retired	7.7	7.8	6.8	5.7	4.3	-3.4
Other non-employed	59.5	75.0	64.7	64.8	63.1	3.6
Total	9.5	10.3	9.7	8.7	7.9	-1.6
Composition of the poor						
Production workers	31.5	30.4	32.7	32.4	36.6	5.1
Clerical workers and teachers	7.3	4.4	5.3	3.5	7.9	0.6
Managerial workers	0.0	0.0	0.0	0.3	0.0	0.0
Self-employed	26.9	24.5	15.8	22.3	19.1	-7.8
Retired	20.5	20.9	19.4	18.8	15.0	-5.5
Other non-employed	13.8	19.8	26.8	22.7	21.4	7.6
Total	100.0	100.0	100.0	100.0	100.0	–

Source: authors' calculations on data from the SHIW-HA (Version 3.0). The social group is defined by the labour market status of the household's head.

Table 5

**DECOMPOSITION OF THE GINI INDEX BY SOCIAL GROUP**  
(per cent)

Component	1993	1995	1998	2000	2002	Absolute change 1993-2002
Within-groups inequality	7.0	7.0	7.1	7.0	6.9	-0.1
Between-groups inequality	12.1	11.7	13.9	12.3	13.2	1.1
Overlapping	14.5	15.0	13.8	14.2	13.2	-1.3
Total inequality	33.6	33.7	34.8	33.5	33.3	-0.3

Source: authors' calculations on data from the SHIW-HA (Version 3.0). The social group is defined by the labour market status of the household's head.

Table 6

**INCOME IMMOBILITY**

Indicator	Italy		Great Britain (1)
	1993-1995	2000-2002	1991-1993
Correlation coefficient for income level	0.77	0.69	0.62
Percentage of persons remaining in:			
same decile group	35	29	32
same quintile group	55	50	51
same absolute income group (2)	50	46	47
same or neighbouring decile group	70	66	66
same or neighbouring quintile group	89	87	87
same or neighbouring absolute income group (2)	85	83	83
Shorrocks index (decile groups) (3)	0.72	0.79	n.a.
Shorrocks index (quintile groups) (3)	0.57	0.63	n.a.

Source: authors' calculations on data from the SHIW-HA (Version 3.0) for Italy; Jarvis and Jenkins (1998), table 1, p. 431, for Great Britain. (1) The data for Great Britain refer to income equalised by the McClements equivalent scale; income components are broadly comparable to the Italian one, but they refers to the month (or relevant period) prior to the interview rather than the previous calendar year. (2) Absolute income groups are defined using cut-offs equal to 0.5, 0.75, 1.0, 1.25 and 1.5 times the mean income in the initial year. (3) The Shorrocks index measures "mobility" and lies between 0 (immobility) and 1 (perfect mobility).

Table 7

**RELATIVE INCOME MOBILITY MATRICES**  
(per cent)

Quintile group in 1993 or 2000	Quintile group in 1995					Quintile group in 2002						
	Bottom 2nd	3rd	4th	Top	All	Bottom 2nd	3rd	4th	Top	All		
Bottom	69	21	7	2	1	100	62	26	6	3	2	100
2nd	20	48	20	10	2	100	26	40	21	10	2	100
3rd	7	22	42	23	6	100	8	23	40	23	7	100
4th	2	8	24	45	21	100	2	7	24	42	24	100
Top	2	1	7	20	70	100	2	4	9	21	64	100
All	20	20	20	20	20	100	20	20	20	20	20	100

Source: authors' calculations on data from the SHIW-HA (Version 3.0). Figures may not add up to totals because of rounding.

Table 8

**ABSOLUTE INCOME MOBILITY MATRICES**  
(per cent)

Income group in 1993 or 2000	Income group in 1995							Income group in 2002						
	<0.50	0.50-0.75	0.75-1.00	1.00-1.25	1.25-1.50	>1.50	All	<0.50	0.50-0.75	0.75-1.00	1.00-1.25	1.25-1.50	>1.50	All
< 0.50	66	24	6	2	1	1	100	59	30	7	1	0	2	100
0.50-0.75	18	53	18	8	1	1	100	18	45	22	11	2	2	100
0.75-1.00	6	23	41	20	6	4	100	4	21	39	22	7	7	100
1.00-1.25	2	12	26	33	18	9	100	1	7	24	31	21	16	100
1.25-1.50	1	4	13	33	22	27	100	0	6	13	22	25	34	100
> 1.50	2	2	4	9	14	69	100	1	3	5	9	16	66	100
All	19	23	19	15	9	16	100	16	22	20	15	10	18	100

Source: authors' calculations on data from the SHIW-HA (Version 3.0). Figures may not add up to totals because of rounding. Absolute income groups are defined using cut-offs equal to 0.5, 0.75, 1.0, 1.25 and 1.5 times the mean income in the initial year.

Table 9

**EFFECT OF PUBLIC REDISTRIBUTION IN EU COUNTRIES IN 1998 AND 2001**  
(per cent)

Country	Income shares of the poor in 1998 (1)			Income shares of the poor in 2001 (1)			Gini index in 1998 (2)		
	Original income	Dispos-able income	Differ-ence	Original income	Dispos-able income	Differ-ence	Pre-tax income	Post-tax income	Differ-ence
Austria	2.2	5.0	2.8	2.0	4.9	2.9	31.3	25.3	6.1
Belgium	1.2	5.0	3.8	1.2	5.2	4.0	31.5	24.1	7.4
Denmark	1.5	5.4	3.9	1.6	4.9	3.3	30.1	24.1	6.0
Finland	1.3	4.8	3.5	1.7	5.6	3.9	28.9	23.3	5.6
France	2.9	5.4	2.5	3.7	6.4	2.7	31.7	28.5	3.2
Germany	2.0	4.9	2.9	2.3	5.6	3.3	33.3	27.6	5.7
Greece	4.6	7.1	2.5	4.4	7.0	2.6	37.5	34.2	3.3
Ireland	1.4	9.1	7.7	1.5	9.2	7.7	37.5	32.0	5.5
Italy	4.5	7.0	2.5	4.5	7.0	2.5	37.8	34.1	3.7
Luxembourg	2.8	4.9	2.1	2.5	4.4	1.9	31.8	25.7	6.2
Netherlands	1.6	4.3	2.7	2.1	5.4	3.3	29.6	25.0	4.6
Portugal	4.0	8.3	4.3	3.9	8.4	4.5	40.4	35.6	4.8
Spain	3.4	6.2	2.8	4.1	7.2	3.1	36.9	33.1	3.8
Sweden	2.3	3.8	1.5	2.6	6.0	3.4	29.8	26.6	3.2
United Kingdom	2.1	7.9	5.8	1.7	6.8	5.1	35.9	31.3	4.6

Source: estimates by EUROMOD as reported in EUROMOD (2004a, 2004b) and Verbist (2004), table 6, p. 17. (1) The poor are defined as persons with equivalent disposable income lower than 60 per cent of the median (OECD modified equivalence scale). Original income includes employment income, property income, private pension benefits, and other private transfers. Disposable income is equal to original income less direct taxes and social security contributions plus social transfers. (2) Distribution of pre- and post-tax equivalent income among persons (OECD modified equivalence scale).

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