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Does consumption inequality track income inequality in Italy?

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ABSTRACT

This paper presents stylized facts on labor supply, income, consumption, wealth, and several measures of consumption and income inequality drawn from the 1980–2006 Survey of Household Income and Wealth (SHIW) conducted by the Bank of Italy. The SHIW provides information on consumption, income and wealth, and a sizable panel component that allows econometricians to estimate sophisticated income, consumption, and wealth processes and to analyze labor market and portfolio transitions. We find that over the sample period income inequality is higher and has grown faster than consumption inequality. Most of the increase in income inequality is related to an increase in the degree of earnings' instability rather than to shifts in the wage structure. We suggest that, in particular, the labor market reforms of the 1990s and 2000s are the most plausible explanation of the increased earnings inequality.

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1. Introduction

The two decades since the mid-1980s have witnessed dramatic changes in the Italian economy: population aging and falling fertility have been accompanied by a sequence of financial reforms that have liberalized credit markets, a series of labor market reforms that have eliminated indexation of wages and increased labor flexibility, and a major pension reform that has increased the retirement age and reduced retirement benefits for future generations. There have also been dramatic changes to fiscal and monetary policy. A period of rising national debt ended in 1992 with a debt stabilization and slow convergence to the Maastricht criteria, and responsibility for monetary policy was delegated to the European Central Bank, bringing an end to an era of sustained inflation. As a consequence, the current macroeconomic environment in which Italian households choose how much to work, how much to save, and how to allocate their savings among real and financial assets, is very different from the environment of only ten or fifteen years ago.

Increasingly, economists are relying on microeconomic data to analyze macroeconomic events and policy shifts; thus, given the rapid changes associated with policy reforms, the Italian economy represents an ideal context. This paper draws attention to some of the data that can be used by applied research to analyze these reforms by presenting some stylized facts on labor supply, income, consumption, and wealth drawn from the Survey of Household Income and Wealth (SHIW), a representative survey of the Italian population conducted by the Bank of Italy. This is an interesting case because, among the OECD countries, Italy ranks very high in terms of income inequality, second only to the US and the UK. In addition, income

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inequality increased substantially in the 1990s, but the education premium, which is often associated with a widening wage structure, has remained approximately constant.

The SHIW has several interesting features. First, it lends itself to the construction of income and consumption series based on microeconomic variables from 1980 to 2006. Second, it provides information also on wealth, and the three variables are available within the same dataset. Third, it has a sizable panel component that enables the estimation of sophisticated income and consumption processes, and analysis of labor market and portfolio transitions. Fourth, income, consumption, and labor supply measures of the SHIW track the corresponding National Accounts aggregate remarkably well. Finally, for each of the main variables of interest to macroeconomists, SHIW contains detailed breakdowns, allowing applied researchers to experiment with alternative measures of income (from labor, capital, transfers), consumption (durable, non-durables, imputed rents) and wealth (real assets, financial assets, debt, and components thereof).

The paper is organized as follows. Section 2 discusses the SHIW, including survey design, quality of data, and characteristics of the panel component. Section 3 describes the macroeconomic context in Italy for the period under analysis, and compares sample averages with national accounts statistics. Section 4 presents trends in hours and wage inequality and Section 5 presents the patterns of consumption and income inequality. We show that both measures of inequality increased over the sample period, but that income inequality has grown faster than consumption inequality, which is similar to the findings for the United States (Blundell et al., 2008) and the United Kingdom (Blundell and Preston, 1998). In Section 6 we discuss some possible explanations for these findings for Italy, and especially those related to the role of credit market reform and financial liberalization, labor market reforms, and changes in the nature of income shocks. Our analysis shows that after declining through most of the 1970s and 1980s, income inequality in Italy grew dramatically in the early 1990s and stayed at this higher level until very recently. We find that most of the increase in income inequality is due to an increase in the degree of instability of earnings and incomes rather than to shifts in the wage structure (consistent with the stability of the education premium). We suggest that the labor market reforms of the 1990s and 2000s may be at the basis of the increased earnings instability. While there is evidence of some increase in consumption inequality, this occurred at a much slower rate than the increased income inequality, in agreement with models of intertemporal choice in which consumers largely smooth transitory income shocks.

2. Household-level data for Italy

The main source of microeconomic data on Italy is the Bank of Italy SHIW, which collects detailed information on demographics, household consumption, labor supply, income, and real and financial wealth.¹ The availability in the same dataset of household data on income, consumption and wealth (as well as a panel component) is what makes the SHIW a unique reference for macroeconomic researchers interested in consumption, income, and wealth inequality, and their changes over time.

2.1. Survey design

The SHIW was conducted annually from 1965 to 1987 (with the exception of 1985). Up to 1984 the number of participant households in a typical year was around 4000. In 1986 the sample size doubled, and since 1987 the survey has been conducted every other year (with the exception of a three-year interval between 1995 and 1998). In 1987 the SHIW over-sampled rich households to collect more accurate statistics on asset holdings. Consumption data (on both durables and non-durables) are available from 1980, with the exception of 1986, when only total consumption information is available.² Income data are available for all years. Information on hours and other dimensions of labor supply are available from 1987. Wealth information is complete, starting from 1987, before which time only information on real assets is available. The last available survey year is 2006. We use data for the 1980–2006 period.

The SHIW is a representative sample of the Italian resident population. The sample design is consistent with that used by the Labor Force Survey conducted by ISTAT (the Italian national statistical institute).³ Data are collected through personal interviews in the first months of the calendar year, thus flow income and consumption refer to the previous year, which in Italy coincides with the calendar year; wealth and debt variables are end-of-period values. Questions concerning the whole household are answered by the head of the family or by the person most knowledgeable about the family finances; questions on individual incomes are answered by each member, wherever possible. The unit of observation is the family, which is defined to include all persons residing in the same dwelling who are related by blood, marriage or adoption. Individuals selected as “partners or other common-law relationships” are also treated as families.

¹ The full dataset is publicly available (with documentation in English) at the Bank of Italy's website, see <http://www.bancaditalia.it/statistiche/indcamp/bilfait/dismicro>.

² For a few years, separate information on food expenditure and medical expenditure is also available. Durables spending is broken down into: vehicles, furniture, and jewelry.

³ Sampling is carried out in two stages: the first consists of the selection of municipalities, the second the selection of households. Municipalities are categorized into 51 strata, defined by 17 regions and 3 classes of population size (over 40,000, 20,000–40,000, less than 20,000). All municipalities in the first group are included; those in the second and third groups are selected randomly with a probability proportional to their population size. In the second stage households are selected randomly from registry office records.

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