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The Income Concept in EU-SILC: Relevance, Feasibility, Challenges

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Abstract: The present paper discusses the income concept in EU-SILC in view of the recommendations of the International Expert Group on Household Income Statistics ('Canberra Group') and its appropriateness for policy-making and policy analysis. The present situation and requirements are assessed as well as the challenges we are facing to make EU-SILC the basic European reference source for data on income, poverty and social exclusion within the European Statistical System. The paper discusses the priorities concerning the measurement of various income components in EU-SILC considering the exhaustiveness as suggested by the Canberra Group, as well as feasibility, current practice and current policy assessments and the need for different income concepts. The paper ends by making recommendations on improving EU-SILC as a relevant source of income data in the EU.

Keywords: European Union; social policy monitoring; European statistics on income and living conditions

1. Introduction

Producing household income data is one of the main objectives of the European Community Statistics on Income and Living Conditions (EU-SILC). In order to produce data that are comparable across countries and regions, among different population groups and over time, we need a standard concept of income. This standard concept should reflect household economic well-being and has to be relevant in view of social policy, *i.e.* it must be suitable for welfare assessment and appraisal, policy-making and policy evaluation. Or more generally, it must contribute to monitoring the social situation in the EU in terms of inputs, outputs and outcome of the European Social Model. Particularly, income data from EU-SILC must be suitable to use in the process of the 'Open Method of Co-ordination' within the EU on social protection and social inclusion.

The *International Expert Group on Household Income Statistics* ('Canberra Group') developed from 1996 to 2001 a guide to compilers on how to prepare harmonised and comparable statistics on income distribution (International Expert Group on Household Income Statistics 2001). This guide is a synthesis of prevailing ideas and best practices which try to reconcile the dual concerns to be faithful to the conceptual nature of income and its theoretical definition, whilst taking into account the practical difficulties of data collection and compilation including the costs involved to the agencies producing the statistics and the burden on households and institutions providing the raw material.

The Canberra Group guidelines reflect how economic societies are organised and people conduct their lives. Over the passage of time, with social and political transformation, changes in the role of government, globalisation and so on, policy issues and priorities will change. It is thus essential to retain a certain degree of flexibility in developing general standards for statistics on this topic. Thus, acknowledging that there is no single concept or set of concepts that fit all circumstances, the guidelines did not attempt to propose a definitive set of standards for the compilation of income distribution statistics. Rather the aim was to give a systematic presentation of all the issues, both conceptual and practical, which should be considered by producers and users of income distribution statistics. Where sufficient consensus existed about best practice, recommendations were made, in the hope that this would contribute in due course to the availability of more accurate, complete and internationally comparable income statistics compiled to common standards. This should in turn lead to greater transparency in their presentation and better informed use of what are inevitably some of the most complex statistics produced by national and international statistical offices and organisations.

The present paper discusses the proposed income concept in EU-SILC in view of the recommendations of the Canberra Group, its appropriateness for policy-making and social policy analysis and its feasibility and challenges. The next chapter summarises the European policy needs. Chapter 3 focuses on the requirements of policy-relevant income statistics. In chapter 4 the measurement of income in EU-SILC is discussed in view of the policy needs. Chapter 5 describes the present situation concerning the concept and measurement of income in EU-SILC. The challenges we are facing to improve EU-SILC as the basic European reference source for data on income, poverty and social exclusion are discussed in chapter 6. Finally, chapter 7 presents conclusions and recommendations on the priorities concerning improving the measurement of income in EU-SILC.

2. Policy objectives and policy needs

The purpose of EU-SILC is to serve as the basic European reference source for data on income, poverty and social exclusion (European Parliament and Council of the European Union 2003, Article 1). More generally, EU-SILC must contribute to monitoring the social situation in the EU Member States in terms of the European Social Agenda (European Commission, Directorate-General for Employment, Social Affairs and Equal Opportunities 2005). Particularly, income data from EU-SILC must be suitable to use in the process of the ‘Open Method of Co-ordination’ (OMC) within the EU on social protection and social inclusion.

The current Common Objectives with regard to social protection and inclusion policies in the EU were endorsed by the March 2006 Employment, Social Policy, Health and Consumer Affairs Council (Council of the European Union 2006). The OMC process has also been streamlined in respect of the revised Lisbon process of growth and jobs and in respect of the mutual co-ordination of social policies. In its Communication *Working Together, Working Better: Proposals for a New Framework for the Open Co-ordination of Social Protection and Inclusion Policies* of December 2005 the European Commission has set forward proposals for the streamlining of the OMC in the field of social protection and inclusion (European Commission 2005).

In the face of the emerging challenges, according to the Council, modernising social protection systems remains essential in order to implement social justice for women and men and promote the active participation of all in society. In particular, the EU needs to respond to the challenges of globalisation and demographic change, including through addressing the related challenges in the fields of pensions, health and long-term care and pursuing a better balance between work and family life. Strengthening social cohesion is a fundamental objective of the EU and growth and employment are a means towards the end of more social cohesion. Making a decisive impact on the eradication of poverty, including child poverty, and social exclusion by the year 2010 remains a central priority of the Lisbon strategy.

The current *Common Objectives* with regard to social protection and inclusion policies in the EU consist of overarching objectives and objectives that apply to the different strands of work: (i) making a decisive impact on the eradication of poverty and social exclusion; (ii) providing adequate and sustainable pensions; and (iii) providing accessible, high-quality and sustainable health care and long-term care (European Commission, Directorate-General for Employment, Social Affairs and Equal Opportunities 2006).[1]

As for monitoring of these Common Objectives, the EU Social Protection Committee has proposed a new *monitoring framework* consisting of a portfolio of overarching indicators and three strand indicators portfolios. All four portfolios consist of primary indicators, secondary indicators and context indicators. Indicators can be commonly agreed EU indicators or commonly agreed national indicators. Although the latter are based on commonly agreed definitions and assumptions, they do not allow for a direct cross-country comparison and do not necessarily have a clear normative interpretation. EU-SILC data will be used to construct most of the indicators which monitor progress on the various objectives.[2]

3. Policy-relevant income statistics

Users of income statistics need data which are *relevant* and *authoritative*. Income statistics which do not measure the most relevant aspects of the issue users are inter-

[1] These Common Objectives are stated in the Annex of this paper.

[2] Currently, EU-SILC is the data source for 11 out of the 21 commonly agreed indicators of social exclusion and poverty (European Commission, Directorate-General for Employment, Social Affairs and Equal Opportunities 2006, Annex I.A).

ested in have little to offer. The same holds for income statistics which are questionable as to reliability, bias and comparability. The relevance of statistical information reflects the degree to which it meets the real needs of users. The most relevant income statistics are those which are recurrently available for monitoring the long-run problems on the social policy agenda. Often the findings of those income statistics assist in setting the agenda.

Impartiality, integrity and professionalism are the qualities producers of income statistics have to emanate in order to produce authoritative statistics. Producers of income statistics have to try to:

- avoid the publication of statistical data that contradict each other, or which seem to contradict each other because of confusing differences between concepts or an unclear revision policy;
- publish consistent time series;
- publish statistics of which validity is enhanced by means of reconciliation and integration of all available sources;
- timely publish preliminary results (in order to prevent the publication of 'quick and dirty' contradictory data);
- follow international standards.

The authority and, by implication, the relevance of income statistics will be increased, if they can be fitted into broader statistical systems such as the National Accounts and if they can be used in connection to the most widely used demographic and economic time series.

Producing comparable household income distribution data is one of the main objectives of EU-SILC. Analysts and policy makers identify three main purposes for compiling information on income distribution. The first one is driven by a desire to understand how the pattern of income distribution can be related to patterns of economic activity and the returns to labour, capital and land and to the way in which societies are organised – *i.e.* to theoretical and institutional considerations. The second one reflects the concern of policy makers to determine the need for both universal and socially targeted actions on different socio-economic groups and to assess their impact. The third one is an interest in how different patterns of income distribution influence household economic well-being and people's ability to acquire the goods and services they need to satisfy their needs.

Producers of income distribution statistics, therefore, have to address such questions as:

- How many 'poor' people are there in a given country? How does this compare with earlier years, or with other European countries?
- Who are the 'poor'? Has this changed over time?

- How unequal is the distribution of income in a given country? How does this compare with earlier years, or with other European countries?
- Have the rich become richer? The poor become poorer?

The audience for income distribution statistics is usually less conscious of the ambiguities surrounding concepts such as 'income,' 'poor' and 'rich' than are the producers of the statistics. 'Income' may often be thought of by the user in terms of cash income; the 'poor' are those whose lack of income means they are restricted to a low standard of living – *i.e.* there is an implicit assumption that 'income' constraints are binding on poor people's consumption - and the 'rich' are those who can afford a luxurious lifestyle. Typically, the main focus of interest is on changes over time, with differences between countries coming a close second. Statisticians' statements about incomes are interpreted as statements about the living standards experienced by different sections of the population; those with the lowest incomes are assumed to have the lowest living standards. Thus interest in income distribution may be justified either per se as a way to see how the benefits of national product are distributed across people, or indirectly as the best proxy for the distribution of economic well-being.

4. The measurement of income in EU-SILC

A household's economic well-being can be expressed in terms of its access to goods and services. The more that can be consumed, the higher the level of economic well-being, though the relationship between the two is not a linear one. Measuring consumption might therefore be a way of measuring economic well-being. However, a household may be able to choose not to consume the maximum amount it could in any given period but to save at least some of the resources it has available. By saving, households can accumulate wealth through the purchase of assets which will both generate income at a later date and serve as a 'nest-egg' for spending at a later time when income levels may be lower, or needs higher, than now. In addition to potentially earning a return for the household, ownership of wealth also affects their broader economic power. For example, wealthy households may find it easier to gain credit to finance their consumption. Thus to capture the full extent of a household's economic well-being it is desirable to look at a number of different aspects of their economic situation including not only income but also levels of wealth (the level of net worth – assets minus liabilities) and changes in the value of that wealth. Analysis of economic well-being is usually primarily concerned with the comparison of the actual or potential living standards of different groups in society and across societies, at a point in time and also over a period of time. Policies to address social cohesion generally focus on income in some form or other. In other words, income is normally the most objective proxy for economic well-being for policy purposes.

The Canberra Group's basic principle is to include in the definition of income all components that in one way or another contribute to the maximum amount that a household, or other unit, can afford to consume during a certain period (usually a year) without having to finance its consumption by reducing its cash, by disposing of other financial or non-financial assets or by increasing its liabilities.[3] In broad terms, income refers to regular receipts such as wages and salaries, income from self employment, interest and dividends from invested funds, pensions or other benefits from social insurance and other current transfers receivable. Large and irregular receipts from inheritances and the like are considered to be capital transfers, because it is unlikely that they will be spent immediately on receipt and are 'one off' in nature.

Income thus defined presents a partial view of economic well-being and represents the regular or recurring receipts of households (*i.e.* current economic well-being). It provides a measure of resources available to the household for consumption and saving. Consumption expenditure of households represents the day-to-day purchases that may be financed not only by regular or recurring income but also by savings from previous years or by incurring debt. For some households, such as retired households, the running down of capital for consumption may represent a deliberate attempt on their part to even out consumption over a life time. Other groups in the population, such as farmers, may also average out their consumption over a number of years while their incomes may show quite wide fluctuations over the same period. In such cases, consumption expenditure may represent a better estimate of the household's sustainable standard of living.

Having chosen current economic well-being as the organising principle, there were three other dimensions along which further choices of income components had to be made. These were cash (*i.e.* monetary) versus non-cash income, regular versus irregular income and maintenance of the value of net worth. Decisions on what to include and exclude along these dimensions were governed by the extent to which the component in question may be 'spent today'.

Measurement constraints

Besides theoretical requirements, the income concept must be measurable, either from surveys and/or from administrative data sources. Most income distribution statistics rely on data collected in household surveys, although in some countries administrative sources are used, for example tax and/or social benefit records or personal income registers. However, it is highly unlikely that either type of source can provide the level of detail of data which the desired income concept demands.

[3] This definition is based on the Hicksian notion of income: "a person's income is what he can consume during the week and still expects to be as well of at the end of the week as he was at the beginning" (International Expert Group on Household Income Statistics 2001, pp. 11-12).

Household surveys are constrained by the information it is feasible to expect people to be able to provide with reasonable accuracy during the course of an interview. Recourse to administrative records might appear to circumvent most of the problems associated with primary data collection. Income tax records are the most important of such sources and have historically provided long-run time series of continuous data. However, they also have their drawbacks. For this reason, tax records are typically used in conjunction with other sources, for example social security information for non-taxpayers. Appropriate use of these files almost always involves direct matching of individual records by a personal identifier and, hence, runs up against privacy and confidentiality concerns.

Income measurement must also be able to meet the requirements of different quality criteria, such as timeliness, accuracy and coherence. Consequently, we need to find a proper balance between policy and analytical requirements on the one hand and measurement constraints, in terms of data collection design, response burden and cost effectiveness on the other. All these considerations have eventually led to the following income definitions in EU-SILC (European Parliament and Council of the European Union 2003, Article 2 and further specified in European Commission 2003, Annex I):

a) *Gross household income*: the total monetary and non-monetary income received by the household over a specified 'income reference period', before deduction of income tax, regular taxes on wealth, employees', self-employed and unemployed (if applicable) persons' compulsory social insurance contributions and employers' social insurance contributions, but after including inter-household transfers received;

b) *Disposable household income*: gross household income less income tax, regular taxes on wealth, employees', self-employed and unemployed (if applicable) persons' compulsory social insurance contributions, employers' social insurance contributions and inter-household transfers paid.

5. Where do we stand?

The Canberra Group has made a number of general recommendations in its report (summarised in International Expert Group on Household Income Statistics 2001, pp. xiii-xvi). These general recommendations have been followed in the design of EU-SILC, although it was acknowledged that not all recommendations could fully be implemented from the start of the project. Concerning the income definitions in the 2003 Framework Regulation of EU-SILC, therefore, EU Member States were allowed some years to adapt their data collection to EU-SILC standards (European Parliament and Council of the European Union 2003, Article 15). This consideration especially referred to the collection or calculation of income components, which are difficult to observe.

New income components that have to be included in the income data collection in EU-SILC as from 2007 are:

- Non-cash employee income
- Employers' social insurance contributions
- Imputed rent[4]
- Interest paid on mortgages
- Value of goods produced for own consumption.

Besides, all income components will have to be measured *gross*, *i.e.* including any taxes and social insurance contributions.

Consequently, as from 2007 the income concepts in EU-SILC will be in line with the recommendations made by the Canberra Group. With regard to cross-sectional information EU-SILC will then have accomplished its goal in terms of relevance and comparability. However, three important limitations will remain. First, household disposable income in EU-SILC does not include so-called *social transfers in kind*. These transfers reflect the value of individual services of government to households, such as publicly financed education and health care, food, housing and transport subsidies and in-kind social assistance. Second, EU-SILC does not measure (realised) *capital gains*, *i.e.* proceeds from selling off by households assets that have risen in value. Third, EU-SILC will be restricted to the population living in *private households*, as is typical of all household surveys. This means that homeless persons and other difficult-to-reach persons as well as people living in institutions such as homes for the elderly, nursing homes, psychiatric hospitals and prisons are not included in the results.

Besides the inevitable sampling errors, the limitations in the EU-SILC data mentioned above will of course hamper the analysis of income inequality and poverty. Consequently, collecting information on these phenomena remains an important challenge. However, EU-SILC is not the proper instrument to meet these challenges. As we consider these phenomena to be beyond the scope of EU-SILC, we will not make any recommendations in this paper on how to overcome these shortcomings.

The first *longitudinal information* from EU-SILC will become available as from 2009. At that moment it will also be possible to produce information on income dynamics. However, longitudinal data from EU-SILC will be based on periods of 4 years, which is the minimum required panel duration for EU-SILC. Although some countries run longer term panels, at an European level EU-SILC will not provide data to analyse long-term income dynamics, which may be seen as another shortcoming. Since we still have to wait for some years before we will be able to assess

[4] The money that a household saves on full (market) rent by living in their own accommodation or in accommodation rented at a price that is lower than the market rent.

the longitudinal data from EU-SILC, it is not very fruitful to make recommendations at this stage.

Looking at the short term we see the remaining challenges concerning EU-SILC in the area of feasibility of the instrument. This means a focus on process quality, in particular the survey process, measurement errors in income components, non-response and timeliness. All efforts towards improving the data quality, however, will have to consider the burden that can be put on respondents and the resources that are available to the data producers.

6. Remaining challenges

Although many satisfactory results have been achieved since the launch of the EU-SILC project, a lot of challenges still remain. From a conceptual point of view the main challenges are:

- Measurement or imputation of gross income components;
- Full coverage of the income concepts total household gross income and disposable income;
- Treatment of negative or strongly fluctuating income from self-employment;
- Enhancing the coherence by making comparisons and reconciliations with other data sources.

Some of the challenges are hard to overcome in terms of the desired accuracy of income data. Therefore, it is useful to look at the remaining challenges in view of the impact they will have on indicators used in the framework of policy assessment of the European social protection and social inclusion policies, both at EU level and at national level. The amount of resources it will take to overcome the remaining challenges is of course also an important issue to consider.

The inclusion of gross income components and employers' social insurance contributions in EU-SILC have no impact on the indicators that are used at present in the OMC on social protection and social inclusion policies. The inclusion of non-cash income components like the rental value of owner-occupied dwellings and the value of goods produced for own consumption, however, may have an impact on the indicators used, notably on the at-risk-of-poverty indicators.[5] However, it should be recognised in this regard that the choice of a specific equivalence scale to adjust the distribution of income for differences in the size and composition of households for some countries also has large impact on the resulting indicators, notably the at-risk-of-poverty rates.

[5] This is particularly the case for the elderly, who have often been able to accumulate wealth in the form of housing assets.

EU-SILC measures income components to calculate gross household income and disposable household income. Besides these two core concepts a number of other income concepts can be derived from EU-SILC. In each case the income concepts used in the calculation of the indicators should be assessed against their fitness for purpose. This is especially true for the treatment of income from self-employment, as it can be negative or it can strongly fluctuate over time. Particularly in countries with considerable self-employment, the way entrepreneurial income is included in EU-SILC data can have a serious effect on measuring risks of poverty for certain population groups.

Finally, we should acknowledge that some income components are hard to measure, despite all the efforts we will put into their measurement. Income from self-employment and non-monetary income components (notably imputed rent) cause measurement problems in any income statistics in any country at any point in time.

7. Conclusions and recommendations

The recommendations we make in this paper on improving the European Statistics on Income and Living Conditions are part of the principles of data quality management as formulated in the quality declaration of the European Statistical System. Moreover, further improvement of the EU-SILC instrument also fits into the implementation and monitoring of the European Statistics Code of Practice (Statistical Programme Committee of the European Union 2005). Furthermore, many of the recommendations made in this paper have already been discussed or touched upon in the July 2005 independent report on *Taking Forward the EU Social Inclusion Process* (Atkinson *et al.* 2005, Chapter 5).

With respect to improving the data quality of EU-SILC, we recommend to focus the efforts on the quality dimensions *accuracy*, *coherence* and *comparability*. In particular efforts should be concentrated on suppressing biases caused by unit and item non-response (especially in case of differential non-response rates), measurement errors (notably under-reporting of income data) and processing errors. Comparisons and reconciliations of EU-SILC results with other national data sources or harmonised European data sources are essential in this respect.

The selection and definition of EU social inclusion and social protection *policy assessment indicators* will further benefit from careful analysis of the fitness for purpose of the EU-SILC concepts used in the light of the data quality that might reasonably be expected. Special attention should be paid to the treatment of negative or strongly fluctuating *income from self-employment* in the published income data.

The production of *quality reports* as stipulated by the EU-SILC Framework Regulation is of vital importance to the project. However, a recurrent production of quality reports – or Robustness Assessment Reports as proposed by the Canberra Group –

will be key to assess the results, especially for the hard-to-measure income components.

Finally, we should continue our work on *methodological studies* to improve the income measurement in EU-SILC as well as its other features. By exploring, documenting and comparing modes of data collection and types of procedures used in the EU Member States, we are able to identify best practices to yield good European and national statistics.

This paper has focussed on the relevance, comparability and coherence of EU-SILC. We did not discuss specific issues related to sample selection and design, data collection and processing procedures, timeliness and accessibility of the EU-SILC data. Consequently, the recommendations with respect to improving the relevance, comparability and coherence of EU-SILC will have to be weighted against issues as dealing with non-response, measurement and processing errors, improving timeliness and maintaining cost effectiveness.

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ANNEX: Common objectives with regard to EU social protection and inclusion policies[6]

The current *Common Objectives* with regard to social protection and inclusion policies in the EU consist of overarching objectives and objectives that apply to the different strands of work. The *overarching objectives* of the OMC for social protection and social inclusion are to promote:

(i) social cohesion, equality between men and women and equal opportunities for all through adequate, accessible, financially sustainable, adaptable and efficient social protection systems and social inclusion policies;

(ii) effective and mutual interaction between the Lisbon objectives of greater economic growth, more and better jobs and greater social cohesion and with the EU Sustainable Development Strategy;

(iii) good governance, transparency and the involvement of stakeholders in the design, implementation and monitoring of policy.

With regard to *making a decisive impact on the eradication of poverty and social exclusion* the objectives are to ensure:

(i) access for all to the resources, rights and services needed for participation in society, preventing and addressing exclusion, and fighting all forms of discrimination leading to exclusion;

(ii) the active social inclusion of all, both by promoting participation in the labour market and by fighting poverty and exclusion;

(iii) that social inclusion policies are well-coordinated and involve all levels of government and relevant actors, including people experiencing poverty, that they are efficient and effective and mainstreamed into all relevant public policies, including economic, budgetary, education and training policies and structural fund (notably ESF) programmes.

Concerning providing *adequate and sustainable pensions* the objectives are to ensure:

(i) adequate retirement incomes for all and access to pensions which allow people to maintain, to a reasonable degree, their living standard after retirement, in the spirit of solidarity and fairness between and within generations;

(ii) the financial sustainability of public and private pension schemes, bearing in mind pressures on public finances and the ageing of populations, and in the context of the three-pronged strategy for tackling the budgetary implications of ageing, notably by: supporting longer working lives and active ageing; by balancing contributions and benefits in an appropriate and socially fair manner;

[6] As endorsed by the March 2006 Employment, Social Policy, Health and Consumer Affairs Council of the European Union.

and by promoting the affordability and the security of funded and private schemes;

(iii) that pension systems are transparent, well adapted to the needs and aspirations of women and men and the requirements of modern societies, demographic ageing and structural change; that people receive the information they need to plan their retirement and that reforms are conducted on the basis of the broadest possible consensus.

With respect to providing *accessible, high-quality and sustainable health care and long-term care* the objectives are to ensure:

(i) access for all to adequate health and long-term care and that the need for care does not lead to poverty and financial dependency; and that inequities in access to care and in health outcomes are addressed;

(ii) quality in health and long-term care and by adapting care, including developing preventive care, to the changing needs and preferences of society and individuals, notably by developing quality standards reflecting best international practice and by strengthening the responsibility of health professionals and of patients and care recipients;

(iii) that adequate and high quality health and long-term care remains affordable and financially sustainable by promoting a rational use of resources, notably through appropriate incentives for users and providers, good governance and coordination between care systems and public and private institutions. Long-term sustainability and quality require the promotion of healthy and active life styles and good human resources for the care sector.