

The Luxembourg Wealth Study: Enhancing Comparative Research on Household Finance  
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*Opening Address*  
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In March 2004 the Luxembourg Income Study (LIS) and statistical offices, central banks, and research institutions from several European and North American countries launched the Luxembourg Wealth Study (LWS). The primary objective was to construct a cross-nationally comparable database on household wealth assembling micro-data from existing national sources. The second aim was to establish a network of data producers to share accumulated knowledge and to stimulate a much needed harmonization of concepts and definitions.

The Bank of Italy has supported the project from the beginning. We hosted the intermediate conference in Perugia in January 2005 and we are happy to host the final conference here in Rome today. Indeed, as many of the participants know, since the mid-1960s the Bank has conducted its own Survey on Household Income and Wealth (SHIW). The Survey is widely used; many studies over the years by Bank of Italy and academic economists have made use of its cross-section and panel data. Among these scholars, let me mention the late Albert Ando, a close personal friend of many of us, and for many years an invaluable consultant of the Bank.

As the assembling and standardization of national data sources is now complete, this LWS final conference marks the conclusion of the project. The next stage, as I understand it, will be the release of the LWS database to the research community. It contains a wealth of information on households' net worth and asset portfolio composition, as well as on demographic characteristics, consumption expenditures and sources of income. Data are currently available for ten countries and will be regularly updated in the future as new waves become available and new countries join the project. Though some measurement problems remain, the detailed work on the single items recorded in each of the surveys included in the LWS database appears to have enhanced the degree of cross-national comparability. The project has paved the way for further progress, its database now offering a unique source for cross-national analysis of household wealth.

Now that the first stage of the project is over, it is time to think about the coming stages, notably the development of agreed classifications and rules for the collection of household wealth data

comparable across countries. This afternoon the conference will discuss some important technical issues, and more substantive issues in the next two days. In these opening remarks, I would only like to share a few thoughts about what seem to me to be particularly relevant issues on which the LWS project is especially suited to shed light.

The first point is on the dynamics of household wealth. Obviously, measurement issues are crucial here; and as always the devil is in the details. In the case of household surveys we face problems of under-reporting, over-sampling is often required, and in many cases the imputation of missing data is absolutely essential. But all this also raises difficult problems of comparability and on the use of different sources. And there are problems in the measurement of real estate prices as well as quantities; it is not obvious how shares and participations in unlisted companies should be valued; it is debatable whether one should deal with the household sector or the private sector; more generally, whether households pierce the corporate and/or the government veil.

All this said, I still have the definite impression that in the last fifteen years there has been a substantial rise in wealth-to-income ratios in the developed countries. This has been especially the case for housing wealth. According to the Survey of Consumer Finances, the ratio of real assets to household disposable income in the United States rose from 3.7 in 1992 to 4.8 in 2004; in Italy, according to the SHIW, from 5.3 in 1993 to 6.3 in 2004. This is clearly a pattern shared by many other countries. On the other hand, net financial assets show a much more moderate trend. Overall, although time series of the aggregate level of household net worth still leave much to be desired (and the Bank of Italy is currently in the process of overhauling the estimation of Italian wealth figures, with results that will be presented in another conference later this year), there seems to be little question that over this long period wealth has increased at higher rates, for many countries much higher rates, than household disposable income.

The increase in wealth may reflect the accumulation of personal (and perhaps corporate) saving or changes in asset values. But saving rates do not seem to show marked increases; if anything, in some countries they have been on a declining trend. So, much if not all of the substantial rise in wealth-to-income ratios is due to asset prices. This raises several questions, that matter from analytical as well as policy perspectives. Why have we been observing such a long-term trend in asset prices? What is it that makes for such a significant change in the prices of real, and perhaps to a lesser extent, financial assets relative to consumer goods and services? Since in the case of housing household expenditures have the double nature of reflecting both consumption and

investment decisions, disentangling the one from the other is necessarily complicated and to an extent arbitrary, but we must try to determine how much price increases reflect the former or the latter decisions.

In particular, there may be merit in considering the changes in shelter costs for owner-occupied housing as part of general consumer price changes. In this case, one should conclude that the prices of housing services have gone up substantially compared to other consumer goods and services. A part however, and possibly a significant part, of housing expenditures is clearly of capital-good nature. One should also then conclude that in these years house owners have been able to extract substantial rent from their accumulated real estate (and then the related questions would be: What determined the rent? Who has gained from the relative price changes? And at whose expense, at a country level and globally?).

Anyway, in the first case we have an issue of relevance for monetary stability, in the second for financial stability, especially as house prices have been moving faster in relatively short periods of time and the larger house values have been used as collateral in financial deals. Clearly the LWS data could help substantially in answering some of these questions, comparing the experience of different countries and taking into account the presence of borrowing constraints as well as differences in house ownership. On the latter, it is striking to see how widely home ownership rates differ between countries: in 2000, while in the United States and in the United Kingdom about two households out of three owned their homes, in Germany, in the Netherlands and in Sweden the proportion was 40 to 60 per cent, in Italy about 75 per cent, in Greece and Spain 85 per cent.

A second issue concerns the distribution of wealth across households. With the increase in the wealth-to-income ratios has the distribution of wealth become more unequal? In many countries we have apparently seen, at least since the outbreak of the New Economy, a change in the distribution of incomes, also due to the spread of “superstar income”. This may have led to a more unequal distribution of wealth, as much of this income has probably been saved. And what about the effect of capital gains and losses on real and financial assets? We certainly know that financial wealth is less equally distributed than real estate. This would imply, in the case of capital gains on bonds and equities, a worsening of the distribution of wealth. But what about capital gains on the housing wealth? For some countries in recent years this may even have fully compensated for the greater inequality in the distribution of incomes and of financial net worth.

This is an important question, not only for its distributive or redistributive implications. On the latter there is indeed some evidence that after a substantial increase in wealth inequality in the 1990s, in the course of the current decade wealth inequality has stopped increasing in the United States, and has actually diminished in Italy. This seems to have been the result of a reduction in the inequality of the distribution of real assets relative to financial net worth, as well as a substantial increase of real assets in household portfolios (partly, perhaps primarily, due to the increase in relative prices). The relevance of liquidity and borrowing constraints would be an obvious issue to study, and it would be natural to use in this respect the rich LWS database.

Capital gains and losses on real and financial assets are also worth special attention from a macroeconomic perspective, however. This would be only natural for central bankers, as wealth effects may be a very relevant factor in determining fluctuations in aggregate demand. Studies on wealth effects have been conducted in recent years, also in the Bank of Italy, making use of household surveys. For a given level of net worth, the wealth effect may be defined as the extent to which household consumption changes in response to a change in asset prices relative to the general consumer price level. Conceptually, this is no different from the old Pigou effect, but while that worked through changes in consumer prices that reduced the “value” of money balances in real terms, we now have asset prices rather than consumer prices as the main factor. While consumer prices may be relatively stable, asset prices could move substantially, and the wealth effect could actually be a destabilizing rather than, as was once thought, a stabilizing factor. So the issue now is the risk that a substantial drop in the relative price of houses might have a significant negative effect on aggregate demand. A plausible reading of the estimates is that housing wealth effects are not negligible and may indeed be larger than financial wealth effects. But this issue needs further work, and the LWS clearly provides data for thorough studies at the individual household level, certainly to be preferred to those based on aggregate data.

Finally, the LWS data set has a uniquely valuable feature for the period in which we are currently living. The availability of detailed demographic characteristics of households is extremely important in the context of ageing populations. The implications of longevity risks, the possible substitution or lack of substitution between financial, real and social security wealth, the possibility of extracting value for retirement from the most illiquid component of net worth, i.e. real estate, including through reverse mortgages, are all issues for which the LWS database comes at the right time. Accordingly, I expect the LWS project to continue to deliver precious data and insights in the future.