

SECRETARIAT OF THE PACIFIC COMMUNITY
REGIONAL POVERTY ANALYSIS TECHNICAL WORKSHOP
(Noumea, New Caledonia, 22 September 2007)

“Translating theory into practise in the Pacific context”

DATA SOURCES AND METHODS: USE OF INCOME OR EXPENDITURE DATA?

THE ISSUE

1. Whether to use a household’s income or expenditure to measure its welfare or wellbeing from Household Income and Expenditure Surveys (noting that other surveys for poverty analysis as living measurement surveys have different measures of welfare).

Table 2.6. Which indicator of welfare: income or consumption?	
Income (“potential”)	
<p>Pro:</p> <ul style="list-style-type: none"> • Easy to measure, given the limited number of sources of income. • Measures degree of household “command” over resources (which they could use if they so wish). • Costs only a fifth as much to collect as expenditure data, so sample can be larger. 	<p>Con:</p> <ul style="list-style-type: none"> • Likely to be under-reported. • May be affected by short-term fluctuations (e.g. the seasonal pattern of agriculture). • Some parts of income are hard to observe (e.g. informal sector income; home agricultural production, self employment income). • Link between income and welfare is not always clear. • Reporting period might not capture “average” income of the household.
Consumption (“achievement”)	
<p>Pro:</p> <ul style="list-style-type: none"> • Shows current actual standard of living. • Smoothes out irregularities, and so reflects long-term average well-being. • Less understated than income, because expenditure is easier to recall • Expenditure diaries provide valuable information on food and nutrition, and can be used for gaining insights into food security and patterns of local production 	<p>Con:</p> <ul style="list-style-type: none"> • Households may not be able to smooth consumption (e.g. via borrowing, social networks). • Consumption choices made by households may be misleading (e.g. if a rich household chooses to live simply, that does not mean it is poor). • Some expenses are not incurred regularly, so data may be lumpy. • Difficult to measure some components of consumption, including durable goods.
<p>Source: Based on Albert, 2004. Cited in: Introduction to Poverty Analysis, World Bank Institute, 2005</p>	

2. Problems:

- Income is understated through non-disclosure (deliberate non-disclosure, accidental non-disclosure with numerous sources of income and some get ‘forgotten’)
- Income is understated because it is irregular (households find it difficult to recall income sources and amounts over a 12 month period especially irregular sources such as remittances and gifts)
- Some expenditure types are understated (typically ‘forgotten’ items such as bus money, so-called ‘undesirable’ items and activities such as gambling, smoking and alcohol and illicit drugs)
- Expenditure is supposed to include the change in value (depreciation) of owner occupied housing (referred to as imputed rent) and other ‘durable assets’ as they are consumed (or used) during the survey reference period. But as depreciation and date of purchase etc information is not collected in HIES surveys this is not done in PICTs.
- Both income and expenditure (consumption) is understated because of the low values typically given to home produced and consumed (or given) food and goods.

MAIN APPROACHES

3. Neither income nor expenditure are true measures of welfare or wellbeing. Neither measure intangibles such as the value of custom and traditional knowledge or the value of publicly provided goods such as education and health services household members use.

4. *“Income and consumption vary from month to month, year to year, and over a lifetime. But income typically varies more significantly than consumption. This is because households try to smooth their consumption over time, for instance by managing their savings, or through risk-sharing arrangements (e.g. using remittances). In Less-Developed Countries, most (but not all) analysts prefer to use current consumption than current income as an indicator of living standards in poor countries, because:*

i) in the short-run it reflects more accurately the resources that households control;

ii) over the long-term, it reveals information about incomes at other dates, in the past and future; and

iii) in poor countries, income is particularly difficult to measure accurately.” p 21 Introduction to Poverty Analysis, World Bank Institute, 2005

RECOMMENDED APPROACH

5. Expenditure (consumption) should be used as the measure of a households well being as it is less understated and comes closer to measuring “permanent income”. Expenditure obtained from HIES in PICTs does not fit the full definition of consumption as it does not include depreciated values for the consumption of durable items in the household. However this source of error on the expenditure side is not considered to be as significant as the under reporting of income. Consumption per capita or per adult equivalent should be the commonly used measure of welfare.