

Is Perceived Financial Inadequacy Persistent?

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In an attempt to understand the determinants of financial inadequacy, this paper employs the ability to make ends meet of households as a measure of their perceived financial inadequacy. Using household-level data from the European Community Household Panel (ECHP) that covers eight countries for the period from 1994 to 2001, a dynamic probit model which incorporates both state dependency and individual fixed effects is applied. Exploiting latterly enhanced bias corrected fixed effects probit model, we address the persistent nature of the subjective financial inadequacy by directly estimating fixed effects whilst correcting for incidental parameters and avoiding initial conditions problem of dynamic models. Our results reveal that employing time invariant individual effects to model a subjective monetary perception is vital. Yet controlling for household heterogeneity, income, indebtedness and health status, we document that in addition to the major differences across European households, institutional factors can have adverse effects on the persistent nature of perceived financial inadequacy.