RELATIVE INCOME IN LATIN AMERICA
Predominance of absolute income

- Well-being is a matter of *a person and his/her objects* (possessions)
  - The ‘others’/’context’ plays a nil role

- Economic theory
  - Individualistic bias in economic theory
    - Out-of-context individuals

- Public policy
  - Absolute poverty, thresholds without context
Absolute income

\[ U_{Peter} = I(Y_{Peter}) \]

- Your well-being depends on your income . . . and on your income alone
Your car is what matters for your well-being
Absolute Income

Others’ cars

Your car
Absolute Income

Others’ cars

Your car
Absolute Income

- Your house is what matters for your well-being
Absolute income

Others’ houses

Your house
Absolute Income

Others’ houses

Your house
Absoluteness?

- “No man is an island, entire of itself”
  - What is a good salary?
  - What is a big TV?
  - What is an excellent income?

- Other dimensions
  - Strong
  - Beauty. Handsome
  - Fast
  - Smart
  - Productive
The Social Context

- People are *socially immersed*
- People are *in society*
  - Aspirations
  - Comparisons
  - Standards
  - Evaluation norms
  - Values

- Longstanding tradition in economics
Needs are relative
Consumption and comparisons

- **Context and Comparisons**

  - *Keeping up with the Jones*
  - *Conspicuous consumption, status*
Easterlin Paradox

- Happiness and income
  - Cross-section
  - Time series

- Systemic effects

- Positional society
  - Income as position marker
  - Hirsch
Social comparisons

- Sociological literature
  - Standards
  - Evaluation norms
  - Aspirations
  - Merton, Runciman, Hyman
  - Bourdieu, Baudrillard
Reference groups

- **The group of comparison**
  - Colleagues
  - Neighbors
  - TV
  - Fellow citizens

- **The nature of comparisons**
  - Competition
  - Distance
  - Aspiration
  - Membership
Reference groups

- **The object of comparison**
  - Income
    - Objects observed by a third party (positional goods)
    - Depersonalized society
  - Other objects of comparison
    - Family name
Empirical Study – Latin America

- **Gallup Poll 2007** Latin America
  - 18 countries
    - 14000 observations approx.
  - Well-being
    - Life satisfaction
    - Life evaluation (best-worst life ladder)
  - Income variable
  - Socio-demographic information
    - Age, gender, education, so on
Empirical Study – Latin America

- **Group formation**
  - Whom people do compare to?
    - Some studies: Van Praag, Clark, Senik, Ferrer-i-Carbonell, Luttmer, so on
  - **Group**: country/age/gender
  - **Object**: income comparison
  - **Reference**: mean income in reference group
  - 252 reference groups
Great income dispersion

Average Income by Reference Group
Reference income

Does the income of others in my reference group matter for well-being?

$$swb_{ik} = \alpha_0 y_{ik} + \alpha_1 y_{ref} + \beta edu_{ik} + \delta area_{ik} + \gamma mst_{ik} + \theta country_k + \mu_{ik}$$
### Table 2
Relative Income and Subjective Well-Being
Latin America
Ordinary least squares

<table>
<thead>
<tr>
<th></th>
<th>Life Satisfaction</th>
<th>Life Evaluation</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>ly</strong></td>
<td><strong>0.401</strong>*</td>
<td><strong>0.443</strong>*</td>
</tr>
<tr>
<td><strong>lyref</strong></td>
<td><strong>-0.228</strong>*</td>
<td><strong>-0.304</strong>*</td>
</tr>
<tr>
<td>Incomplete primary</td>
<td>0.46***</td>
<td>0.30**</td>
</tr>
<tr>
<td>Complete primary</td>
<td>0.50***</td>
<td>0.51***</td>
</tr>
<tr>
<td>Incomplete secondary</td>
<td>0.76***</td>
<td>0.72***</td>
</tr>
<tr>
<td>Complete secondary</td>
<td>0.81***</td>
<td>0.91***</td>
</tr>
<tr>
<td>Incomplete technical</td>
<td>0.53***</td>
<td>1.03***</td>
</tr>
<tr>
<td>Complete technical</td>
<td>0.90***</td>
<td>1.12***</td>
</tr>
<tr>
<td>Incomplete university</td>
<td>0.69***</td>
<td>0.87***</td>
</tr>
<tr>
<td>Complete university</td>
<td>0.801***</td>
<td>1.11***</td>
</tr>
<tr>
<td>Post-graduate</td>
<td>0.84***</td>
<td>1.27***</td>
</tr>
<tr>
<td>Small town</td>
<td>-0.08</td>
<td>-0.11</td>
</tr>
<tr>
<td>Large city</td>
<td>-0.04</td>
<td>-0.04</td>
</tr>
<tr>
<td>Suburb</td>
<td>0.06</td>
<td>-0.10</td>
</tr>
<tr>
<td>Married</td>
<td>-0.09**</td>
<td>-0.25***</td>
</tr>
<tr>
<td>Separated</td>
<td>-0.45***</td>
<td>-0.48***</td>
</tr>
<tr>
<td>Divorced</td>
<td>-0.26**</td>
<td>-0.34***</td>
</tr>
<tr>
<td>Widowed</td>
<td>-0.31***</td>
<td>-0.31***</td>
</tr>
<tr>
<td>Stable partner</td>
<td>-0.20***</td>
<td>-0.30***</td>
</tr>
<tr>
<td>Observations</td>
<td>12859</td>
<td>13491</td>
</tr>
<tr>
<td>R_sq</td>
<td>0.149</td>
<td>0.161</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Test</th>
<th>F-value</th>
<th>Prob&gt;F</th>
<th>F-value</th>
<th>Prob&gt;F</th>
</tr>
</thead>
<tbody>
<tr>
<td>$\alpha_0 + \alpha_1 = 0$</td>
<td>4.11</td>
<td>0.043</td>
<td>2.21</td>
<td>0.137</td>
</tr>
</tbody>
</table>

Significance levels: 0.01 (***) , 0.05 (**)
Estimated coefficients for country variables are not presented
Source: Gallup 2007 Latin America Survey

Generalized vs. Person-specific increases in income
Seperating the absolute from the relative impact of a person-specific raise in income

<table>
<thead>
<tr>
<th></th>
<th>Life satisfaction</th>
<th>Life evaluation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Absolute income effect</td>
<td>0.173**</td>
<td>0.139</td>
</tr>
<tr>
<td>Relative income effect</td>
<td>0.228***</td>
<td>0.304***</td>
</tr>
</tbody>
</table>

Significance levels: 0.01 (***) , 0.05 (**) 
Based on estimated coefficients from equation (1); see Table 4. 
Source: Gallup 2007 Latin America Survey
Asymmetric comparisons

- Upward and downward comparisons
  - Differentiate between those who are below and above mean reference-group income

\[
D_{\text{below}} = \begin{cases} 
(l y_{igk}^{\text{ref}} - l y_{igk}) & \text{if } y_{igk} < y_{igk}^{\text{ref}} \\
0 & \text{if } y_{igk} \geq y_{igk}^{\text{ref}} 
\end{cases}
\]

\[
D_{\text{above}} = \begin{cases} 
(l y_{igk} - l y_{igk}^{\text{ref}}) & \text{if } y_{igk} > y_{igk}^{\text{ref}} \\
0 & \text{if } y_{igk} \leq y_{igk}^{\text{ref}} 
\end{cases}
\]
Asymmetric comparisons do not show up

Table 4
Subjective Well-Being and Relative Income
Asymmetric comparison specification
Latin America

<table>
<thead>
<tr>
<th></th>
<th>Life Satisfaction</th>
<th>Life Evaluation</th>
</tr>
</thead>
<tbody>
<tr>
<td>ly</td>
<td>0.172**</td>
<td>0.141</td>
</tr>
<tr>
<td>Dbelow</td>
<td>-0.225***</td>
<td>-0.316***</td>
</tr>
<tr>
<td>Dabove</td>
<td>0.241***</td>
<td>0.263***</td>
</tr>
<tr>
<td>R-squared</td>
<td>0.15</td>
<td>0.16</td>
</tr>
</tbody>
</table>

Test

<table>
<thead>
<tr>
<th></th>
<th>Fvalue</th>
<th>Prob&gt;F</th>
<th>Fvalue</th>
<th>Prob&gt;F</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>0.07</td>
<td>0.79</td>
<td>0.59</td>
<td>0.44</td>
</tr>
</tbody>
</table>

Significance levels: 0.01 (***) , 0.05 (**)
Estimated coefficients from equation (5)
Estimated coefficients for control variables are not shown.
Source: Gallup 2007 Latin America Survey
Low-income people

- Does absoluteness prevail at low-income levels?

\[
d_{\text{poor}} = \begin{cases} 
1 & \text{if } y_{igk} < \text{US}$1.25 \\
0 & \text{if } y_{igk} \geq \text{US}$1.25 
\end{cases}
\]
Relative income also shows up in income poverty

Table 5
Subjective Well-Being and Relative Income
Absolute and relative-income effects and people in poverty
Latin America

<table>
<thead>
<tr>
<th></th>
<th>Life Satisfaction</th>
<th>Life Evaluation</th>
</tr>
</thead>
<tbody>
<tr>
<td>ly</td>
<td>0.176**</td>
<td>0.155*</td>
</tr>
<tr>
<td>dpoor</td>
<td>0.011</td>
<td>0.039</td>
</tr>
<tr>
<td>Dbelow</td>
<td>-0.228***</td>
<td>-0.318***</td>
</tr>
<tr>
<td>Dabove</td>
<td>0.236***</td>
<td>0.240***</td>
</tr>
<tr>
<td>R-squared</td>
<td>0.15</td>
<td>0.16</td>
</tr>
</tbody>
</table>

Significance levels: 0.01 (***) , 0.05 (**), 0.10 (*)
Estimated coefficients from equation (6)
Estimated coefficients for control variables are not shown.
Source: Gallup 2007 Latin America Survey
Conclusions

- **Comparisons matter.** Reference income is important
  - People are in society

- **Relative income larger than absolute income**
  - Positional society and income as positional marker
  - Absolute income nil in evaluative comparisons
  - Evaluative assessments are highly influenced by comparison

- **Upward and downward comparisons do take place**
  - Well-being of those at the income top is sensitive to the gap closing

- **Relativeness similarly important at low income levels**
  - Relative income is also important for those at the income bottom
Comments

- **Systemic effects** are usually not contemplated
  - Overestimating well-being impact of income
  - Well-being impact of getting someone out of income poverty is not the same as getting many out of poverty

- Greater inequality has a well-being cost for those at the bottom
  - Even if their absolute income raises
  - Frustrated even with higher absolute income
Comments

- Leakage economics is not recommended
  - Rapid growth with growing inequality to reduce (absolute) poverty
  - It may reduce absolute poverty, but it may end up reducing the well-being of those at the bottom,

- Epistemological considerations
  - From individualistic bias to people in social context
  - From a normative addressing of inequality (theories of justice) to its well-being study