

RELATIVE INCOME IN LATIN AMERICA

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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*

Absolute Income

- 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?**

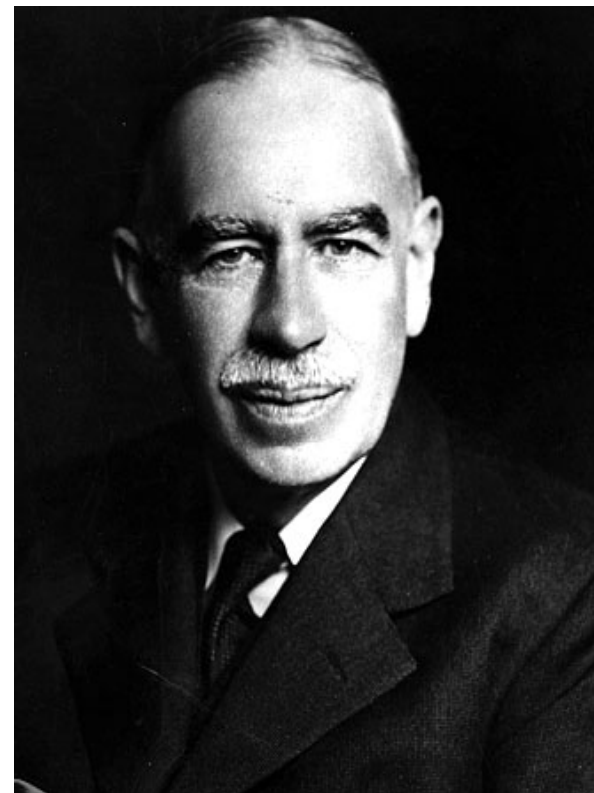
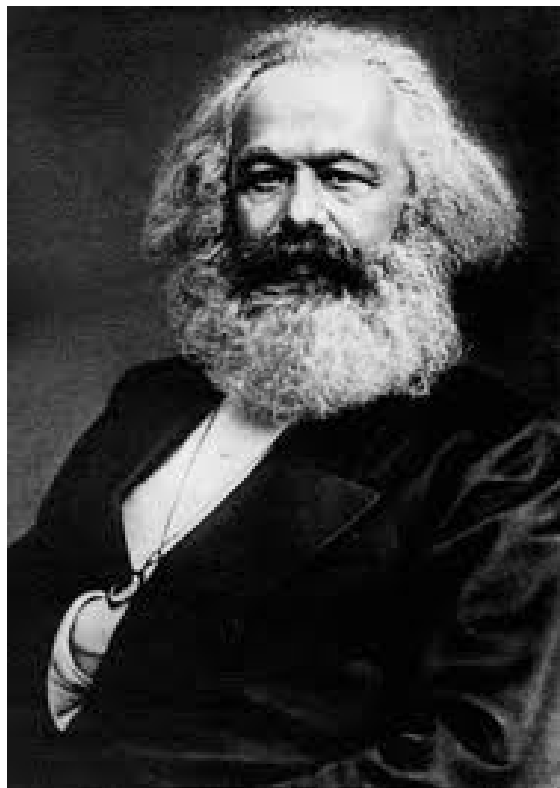
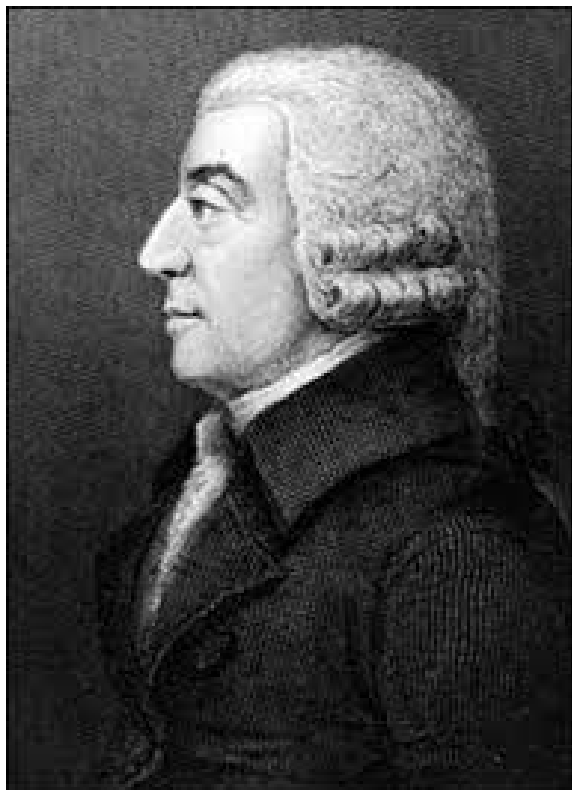
□ **Other dimensions**

- 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

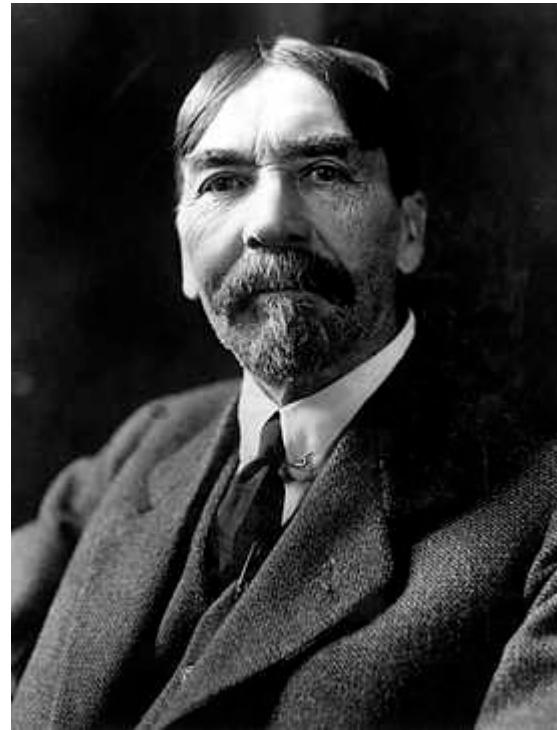


Consumption and comparisons

□ Context and Comparisons



Keeping up with the Jones



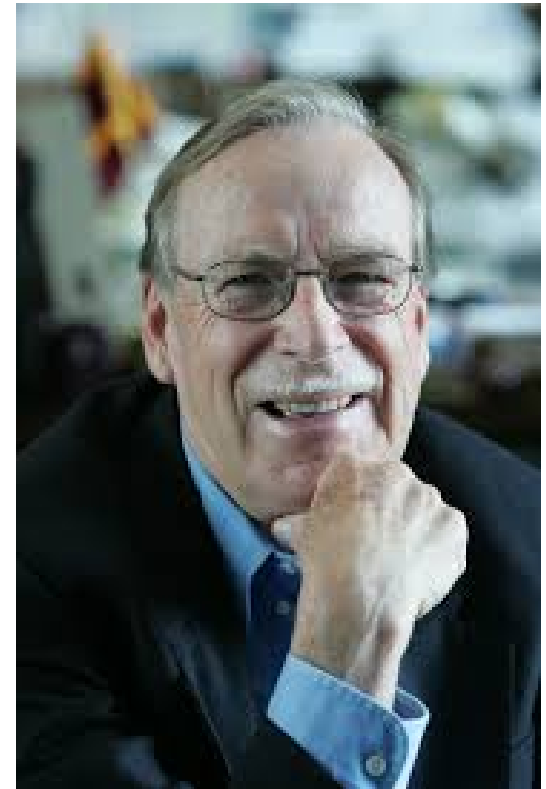
Conspicuous consumption, status

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



Robert Merton

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

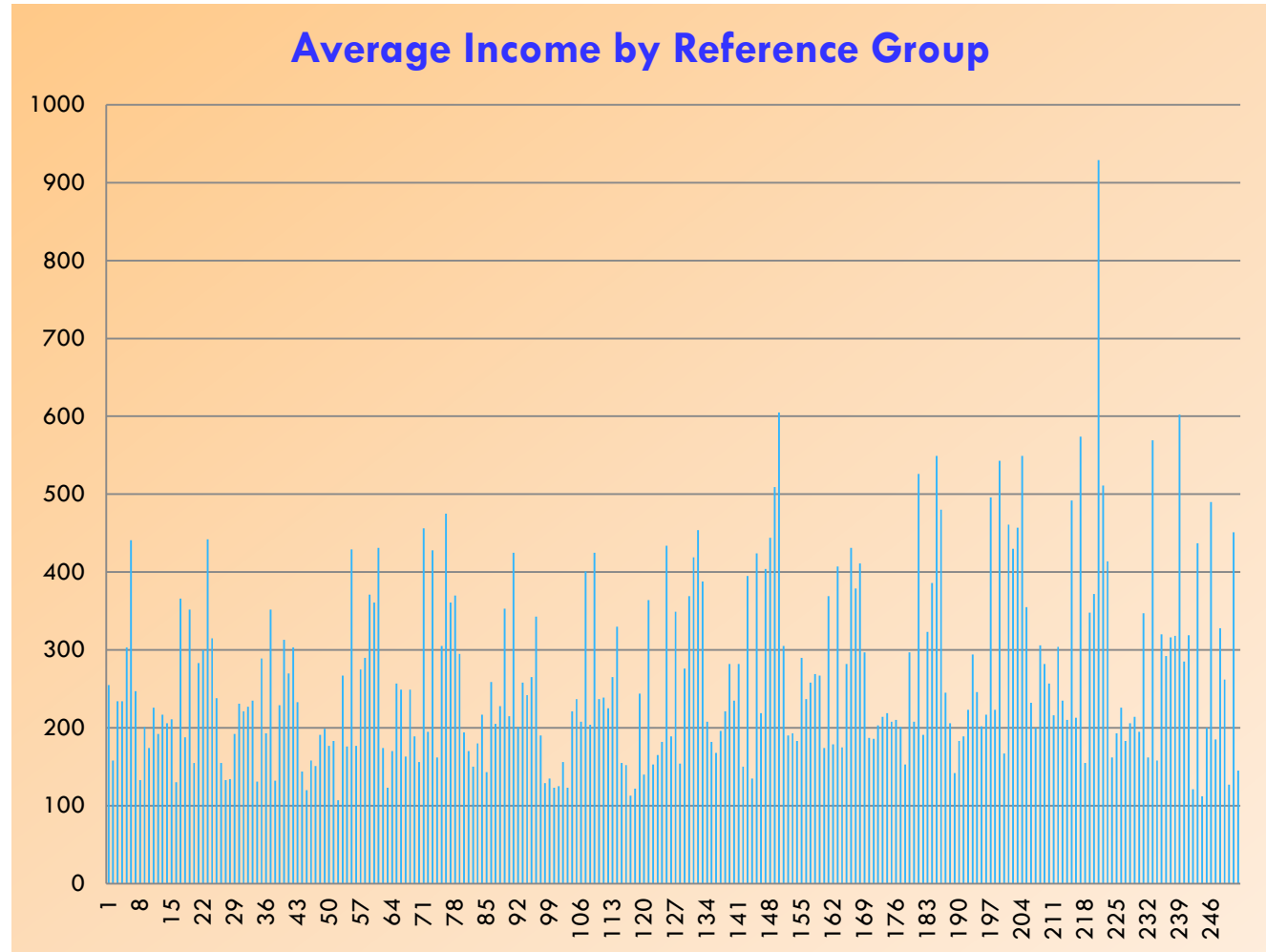
□ **Object:** income comparison

□ **Reference:** mean income in reference group

- 252 reference groups

Great income dispersion

□ Income



Reference income

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

$$swb_{igk} = \alpha_0 ly_{igk} + \alpha_1 ly_{gk}^{ref} + \beta edu_{igk} + \delta area_{igk} + \gamma mst_{igk} + \theta country_k + \mu_{igk}$$

Table 2
Relative Income and Subjective Well-Being
Latin America
Ordinary least squares

	Life Satisfaction		Life Evaluation		
ly	0.401***		0.443***		
lyref	-0.228***		-0.304***		
Incomplete primary	0.46***		0.30**		
Complete primary	0.50***		0.51***		
Incomplete secondary	0.76***		0.72***		
Complete secondary	0.81***		0.91***		
Incomplete technical	0.53***		1.03***		
Complete technical	0.90***		1.12***		
Incomplete university	0.69***		0.87***		
Complete university	0.801***		1.11***		
Post-graduate	0.84***		1.27***		
Small town	-0.08		-0.11		
Large city	-0.04		-0.04		
Suburb	0.06		-0.10		
Married	-0.09**		-0.25***		
Separated	-0.45***		-0.48***		
Divorced	-0.26**		-0.34***		
Widowed	-0.31***		-0.31***		
Stable partner	-0.20***		-0.30***		
Observations	12859		13491		
R_sq	0.149		0.161		
Test	$\alpha_0 + \alpha_1 = 0$	F-value	Prob>F	F-value	Prob>F
		4.11	0.043	2.21	0.137

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

Increase in income

- Separating the absolute from the relative impact of a person-specific raise in income

Table 3
Subjective Well-Being and Absolute and Relative Income Effects
Latin America

	Life satisfaction	Life evaluation
Absolute income effect	0.173**	0.139
Relative income effect	0.228***	0.304***

Significance levels: 0.01 (***), 0.05 (**)

Based on estimated coefficients from equation (1); see Table 4.

Source: Gallup 2007 Latin America Survey

Asymmetric comparisons

(3)

□ Upward and downward comparisons

(4)

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

$$D^{below} = \begin{cases} (ly_{igk}^{ref} - ly_{igk}) & \text{if } y_{igk} < y_{igk}^{ref} \\ 0 & \text{if } y_{igk} \geq y_{igk}^{ref} \end{cases}$$

$$D^{above} = \begin{cases} (ly_{igk} - ly_{igk}^{ref}) & \text{if } y_{igk} > y_{igk}^{ref} \\ 0 & \text{if } y_{igk} \leq y_{igk}^{ref} \end{cases}$$

Asymmetric comparisons

- Asymmetric comparisons do **not show up**

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

	Life Satisfaction		Life Evaluation	
ly	0.172**		0.141	
Dbelow	-0.225***		-0.316***	
Dabove	0.241***		0.263***	
R-squared	0.15		0.16	
Test	Fvalue	Prob>F	Fvalue	Prob>F
	0.07	0.79	0.59	0.44

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?

$$d_{poor} = \begin{cases} 1 & \text{if } y_{igk} < US\$1.25 \\ 0 & \text{if } y_{igk} \geq US\$1.25 \end{cases}$$

Relativeness in low-income levels

- 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		
	Life Satisfaction	Life Evaluation
ly	0.176**	0.155*
dpoor	0.011	0.039
Dbelow	-0.228***	-0.318***
Dabove	0.236***	0.240***
R-squared	0.15	0.16

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