Does income inequality really hurt?

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"O.K., if you can't see your way to giving me a pay raise, how about giving Parkerson a pay cut?"

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Absolute *vs* relative income

- The **absolute income hypothesis**: absolute income matters because it allows each person to fill additional needs

$$U = u(y,z)$$

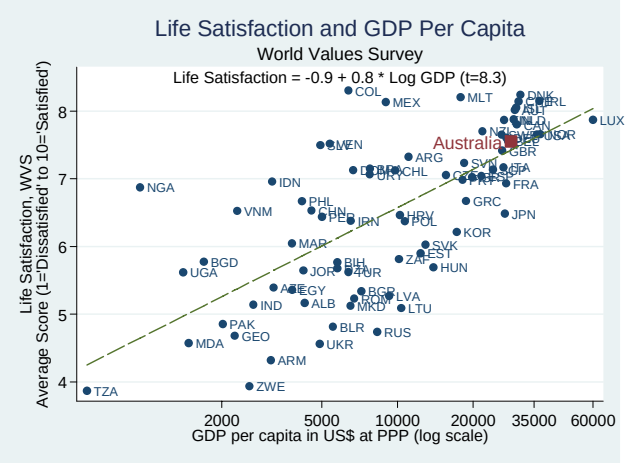
→ economic growth will bring happiness to everyone!

- The **relative income hypothesis**: people assess the adequacy of their incomes in relation the income of others

$$U = u(y,y^*,z)$$

→ happiness is partly a zero sum game → targeting inequality will raise happiness

absolute income matters!!!



and relative income?

- the evidence: in almost every country studied the rich are happier than the poor after controlling for income (Argyle 1999; Blanchflower and Oswald 2004; Diener, Sandvik, Seidlitz and Diener, 1993…and many many others….
- the explanation: social comparisons; those with more compare with those with less and feel good about that and vice versa.

Criticisms:

- The relative income effect is much smaller than it is often stated
- Social comparison do not take place in such a simplistic way

Social comparisons and personality

- **Early models** of social comparison emphasized contrast effects in explaining its influences on SWB
- **More recently** psychologist have shown that comparison processes are more complex
  - object of comparison
  - Reference group, type of comparison: upwards or downwards…
  - Effects of the comparison
- The individual needs to choose the former and that depends on his/her personality (more optimistic individuals make more beneficial use of social comparisons).

→in order to say something about the effects of income inequality on life satisfaction personality needs to be accounted for.

- **income inequality may affect individuals differently**
- **income inequality may not affect individuals at all since they may base their comparisons in other objects**.

This is what I want to test!

The data

- The British Household Panel Survey (18th waves, every year since 1991)
- *"All things considered, how satisfied or dissatisfied are you with your life as a whole using the 1-7 scale"* being 1 *'not satisfied at al'* and 7 *'completely satisfied'*.
- In its 15th wave, personality questions were introduced

my sample

- 10 waves between 1995 and 2007
- N= 20,177 observations
- 3,069 individuals

→individuals in employment who were interviewed in the 15th wave and for whom there are no missing values…

Distribution of Reported Life Satisfaction Levels (wave 15)

	N	*%*
1. not satisfied at all	22	0.42
2	85	1.61
3	299	5.67
4. not sat/dissat	794	15.06
5	1,893	35.9
6	1,821	34.53
7. completely satisfied	359	6.81
N	5,273	100

Life Satisfaction Regressions

	cross-section (wave 15)		cross-section (pooled data)		panel (FE)	
	lifesat	lifesat	lifesat	lifesat	lifesat	lifesat
VARIABLES	(1)	(2)	(3)	(4)	(5)	(6)
lincome	0.042	0.041	0.107***	0.103***	0.104***	0.104***
	(0.046)	(0.042)	(0.021)	(0.020)	(0.026)	(0.026)
ri=belowmean	-0.095**	-0.092	-0.073***	-0.051	0.001	0.040
	(0.047)	(0.242)	(0.023)	(0.128)	(0.025)	(0.188)
ri*agreeabl.		0.085***		0.075***		0.005
		(0.032)		(0.017)		(0.026)
ri*consc.		-0.052		-0.049***		-0.026
		(0.032)		(0.017)		(0.026)
…						

Standard errors in parentheses
*** p<0.01, ** p<0.05, * p<0.1

- The cross-sectional results that I have shown are from wave 15 and using mean income of the sample as the ref. group, but I do get very similar results if I use other reference groups (same gender, same region) but not with others (same age, same social class, education or wages equation)
- Using other waves would not change the results much

From the cross sectional analysis

- income inequality does not automatically lead to suffering or joy. Personality seems to moderate this effect.
- the effects of income inequality are unequally distributed across the population
- the RI effect is small in any case → individuals below the mean income are just 0.1 points less happy than those above→ the poor are less satisfied due to absolute deprivation not to relative one!

From the longitudinal analysis

- income inequality does not seem to have an effect, changes in relative position are not followed by changes in life satisfaction

- and this is so regardless of your personality

...then, does income inequality really hurt?

- Are those below the mean income less satisfied than those above?
  - Income inequality doesn't seem to hurt much. The effect is small. The poor are less happy because they have less, not because they have less than others
  - Inequality does not not hurt (or benefit) everyone in the same way.
- do changes in relative income affect life satisfaction?
  - It looks like 'no', but:
  - I still need to understand better what I am doing
  - panel analysis for the study of life satisfaction in its infancy! (the little variation in Xi and Yi is a problem

Thank you very much!

How to continue…

- Moving to other objects of comparison in order to have a more comprehensive view of the effects of inequality on happiness or LS (e.g. social class)
- Replicating with other datasets such as the GSOEP

Some thoughts…

- When I say that income inequality does not make individuals less satisfied with their lives I am by no means saying that inequality is good neither that governments should not target it.
- However, if one aims at a happy population, we need to understand what makes people happy…and it looks like inequality is not so important
- Many find this result upsetting but I actually think is good news…

Reverse causality

Causality can go from LS to income (Fredrickson 1998, Lybumorsky et al. 2005)

→theincomecoefficientswould be biasedupwards

*However I thinkifthereis reverse causalitythis may not be verybig:

- personality is more or less equally distributed in the upper and lower parts of the income distribution
- The income coefficients in the panel regressions are evidence of causality in one direction mostly due to time span.

Have the poor a less fortunate personality?

Distribution of personality across income

The Big Five Personality Traits	above the mean		below the mean		difference in mean score
	mean	sd	mean	sd	
extraversion (+0.084***)	4.187	1.122	4.323	1.110	-0.136
agreeableness (+0.092***)	5.005	0.923	5.163	0.968	-0.158
conscientiousness (+0.168***)	5.091	0.926	5.006	1.018	0.086
neuroticism (-0.223***)	3.142	1.183	3.446	1.283	-0.304
openness (+0.024)	4.692	1.019	4.493	1.129	0.199