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Do reference values matter? Some notes and extensions on “income and happiness across Europe”

Andreas C. Drichoutis^{a,*}, Rodolfo M. Nayga Jr.^{b,d}, Panagiotis Lazaridis^c

^a Department of Economics, University of Ioannina, University Campus, Ioannina 45110, Greece

^b Department of Agricultural Economics and Agribusiness, University of Arkansas, 217 Agriculture Building, Fayetteville, AR 72701, USA

^c Department of Agricultural Economics and Rural Development, Agricultural University of Athens, Iera Odos 75, Athens 11855, Greece

^d Norwegian Agricultural Economics Research Institute (NILF), NO-0030, Oslo, Norway

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ABSTRACT

We add to the analysis conducted in an article in this journal authored by Caporale, Georgellis, Tsitsianis, and Yin (2009) (hereafter CGTY) which assessed the relationship between subjective well-being, income and relative income in Europe. Specifically, we note some data management, model/variable specification, and econometric issues that can affect the validity of the findings of CGTY. We then present our own augmented model to test the robustness of the results from the CGTY study. When we try to replicate CGTY's estimation, we find that the main variable of interest, i.e. the reference income variable, reverts sign. We also find several differences in our results, the most important of which is that, in contrast to CGTY's result that suggests a statistically significant negative reference income effect on life satisfaction, reference income does not really significantly affect life satisfaction in our estimations.

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1. Introduction

In a recent article in this journal, Caporale, Georgellis, Tsitsianis and Yin (hereafter CGTY) explore the relationship between subjective well-being, income and relative income in Europe (Caporale, Georgellis, Tsitsianis, & Yin, 2009). For this purpose, they used the first two rounds of the European Social Survey (ESS) dataset. CGTY make a distinction between “life satisfaction” and “happiness” since the former “refers to cognitive states of consciousness, whereas happiness is emotional and mainly concerns intimate matters of life”. They used both measures in their estimations and found similar results but report only the life satisfaction results. In general, they found that income has a positive effect on life satisfaction and that reference income has a negative effect on life satisfaction suggesting that comparison effects are present, consistent with the relative utility hypothesis. When they re-estimate various specifications of their life satisfaction equation they find that for Eastern European countries, reference income has a positive effect on life satisfaction which is consistent with the “tunnel-effect” hypothesis, i.e. higher incomes for certain population segments increase the expectations of the remainder population for future incomes.

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* Corresponding author.

E-mail addresses: adrihout@cc.uoi.gr (A.C. Drichoutis), rnayga@uark.edu (R.M. Nayga Jr.), t.lazaridis@aua.gr (P. Lazaridis).

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When this article was published we were already working with the ESS dataset on income and measures of subjective well-being. It was therefore very tempting (and relatively easy) to try to replicate CGTY's results. We found out, however, that we could not replicate their results. We then contacted the authors and obtained only part of the computer code, which was insufficient to replicate their original results.

Apart from the issue of the computer programs, we will show in the next sections that one of the reasons why we are not able to replicate CGTY's published estimates is that we believe that some of the variables in the dataset were misused. In what follows, we first present what we believe are the shortcomings in their analysis. We then present a consistent estimation of their life satisfaction equation and then outline our own view on how the analysis should have been conducted based on the estimation of an augmented life satisfaction equation and an augmented measure of reference income.

2. Data management of the ESS dataset

CGTY base their empirical analysis in the first two rounds of the ESS dataset for 19 European countries. Their estimations use a sample size of 30,285 observations.

There are some issues with the use of their sample. First, five countries that are available in the cumulative dataset for rounds 1 and 2 were dropped from all subsequent estimations namely Estonia, France, Italy, Ukraine and Slovak Republic. This is not mentioned anywhere in the paper. Second, the authors give the reader the impression that the interviews for the two ESS rounds were conducted in 2002 and 2004, respectively since they use just a one year dummy variable in their empirical specification and note that the observations are "fairly equally split between 2002 and 2004". This is not true. Several countries like Greece, Ireland and Austria have conducted all (or almost all) of their interviews in the years 2003 and 2005. For many other countries, the samples were split (equally or not) between the years 2002 and 2005. If the purpose of the year dummy was to capture time trend effects, then CGTY have failed to do so.

CGTY also limit their sample to full-time salaried employees in order to "control for heterogeneity in life satisfaction responses due to unemployment and other labor market states as well as for variation in responses due to differences in the generosity of unemployment and welfare benefit systems across Europe". In addition, in their life satisfaction equation, they control for personal characteristics (gender, age, marital status), education, health and past unemployment experience during the last 12 months and during the last 5 years. They also include dummies for income categories and a reference income variable which is constructed from the income bands.

There are a number of issues with the selection of the control variables that requires a more thorough discussion. For example, the variables that purport to capture past unemployment experience are not what the authors claim they are. The authors explicitly mention in Table A1 that these two dummy variables are: whether the respondent has any periods of unemployment over the last 12 months and over the last 5 years. However, one can read from the ESS questionnaires the following sequence of three questions:

- a. *Have you ever been unemployed and seeking work for a period of more than three months?*
- b. *Have any of these periods lasted for 12 months or more?*
- c. *Have any of these periods been within the past 5 years?*

Hence, one of the variables that CGTY use is incorrectly defined.

Another issue has to do with the sample size they claimed to use in their estimations. The ESS data set allows one to distinguish between salaried employees based on the question "Using this card, which of these descriptions applies to what you have been doing for the last 7 days?". The card includes the choices: paid work, education, unemployed, sick/disabled, retired, community/military service, housework, other and don't know. After selecting only those that report being on a paid job, the sample size becomes 38,670 of 74,914. Another question has to do with how CGTY defined the full-time employees. Unfortunately, since we obtained only part of the computer code, we can only speculate about it. Since the ESS has a couple of questions on the number of contracted and normal work hours,¹ we assume that this is how they defined full-time employees as well. After keeping only those that reported being on a paid work for the past 7 days, we have 36,198 valid cases for total normal weekly work hours. To get near the sample size used by CGTY, we would have to drop approximately 16% of these observations, which makes us speculate that they used 30 h or more per week as the cut-off point. Applying this cut-off point we further dropped 5434 cases. We also dismissed 12 observations with stated work hours more than 120 h per week.

However, if one checks for the valid cases (non-missing values) in the variable for income bands after dismissing the observations we did, we can now only identify 24,304 valid cases. Even if we used all observations without dropping any based on working hours, we can only get 29,907 observations. Therefore, it makes us wonder how one was able to estimate the life satisfaction equation with a reported sample size of 30,285. Unless there was some income projection for those with missing income values, which is something not mentioned in CGTY's paper, the employed practice casts doubt on the validity of the published results.

In order to construct the reference income variable, CGTY use McBride's (2001) method of assigning to every person the average income of a reference group. The reference group consisted of people of the same gender within the range of 5 years

¹ Normal work hours include overtime as well.

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