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Who cares about relative deprivation?☆

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ABSTRACT

If relative deprivation matters to welfare in poor countries as much as it apparently does in rich ones then one would have to question the priority given to economic growth over redistribution in current development policies. We look for evidence in one of the world's poorest countries, Malawi. Using new survey questions that help address likely biases in past tests, we find that relative deprivation is not the dominant concern for most of our sample, although it is for the comparatively well off, including in urban areas. Our results strengthen the welfarist case for a policy focus on absolute levels of living in poor countries. The pattern of externalities suggests that there will be too much poverty and inequality from the point of view of aggregate efficiency.

1. Introduction

Discussions about how best to fight poverty in poor countries have typically focused on peoples' absolute levels of living, as measured by their command over commodities. This focus is at odds with a large body of work in psychology, sociology and economics arguing that *relative* economic position is the carrier of utility, not absolute consumption; this is often called 'relative deprivation' (RD), following Runciman (1966).[1] There are various theories about how RD might arise, including the idea of 'positional goods' that only give utility when most other people do not have them, and theories that postulate that utility depends on 'aspirations,' as formed by relativist comparisons.[2] The idea of RD has been invoked to explain why the proportion of people who think they are happy has not changed much over time in some developed countries (including the United States), despite economic growth.[3] More direct evidence for RD has been found in studies of the determinants

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[1] There is a large literature; contributions include Easterlin (1974, 1995), Townsend (1979), van de Stadt et al. (1985), Frank (1985, 1997), Oswald (1997), Solnick and Hemenway (1998), Walker and Smith (2001) and Alpizar et al. (2005).

[2] On positional goods see Frank (1999) and on aspirations see Easterlin (2001).

[3] See Easterlin (1974, 1995), Oswald (1997), Frey and Stutzer (2002), Blanchflower and Oswald (2004).

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of people's perceived happiness or satisfaction with life, though most of the evidence has been for developed countries.[4] Frank's (1997) overview of the evidence concludes that:

> "In sum, the claim that satisfaction depends heavily on relative position is supported by considerable evidence from both the psychological literature on subjective well-being and by at least fragmentary evidence from the behavioural economics literature. I am aware of no empirical or theoretical evidence against the claim." (p. 1836)

The idea of RD carries some potentially important, but largely neglected, implications for developing countries. Indeed, finding evidence of RD effects in poor countries as strong as those found in rich ones would cast serious doubt on the welfare-economic justifications for many current development policies. Consider, for example, Luttmer's (2005) striking finding in regressions for self-assessed happiness in the US that the coefficients on log income and log mean neighbors' income add up to roughly zero. This implies that an equal proportionate increase in all incomes (leaving relative inequality unchanged) would have no impact on average happiness. A result as strong as this would clearly lead one to question the emphasis currently placed on promoting economic growth in poor countries. Negative externalities in consumption from RD would also suggest that poor people face inefficiently *high* incentives to escape poverty, because they do not take account of the negative spillover effects of their income gains on social comparators. By this view, promoting poverty reduction would entail welfare efficiency costs—pointing to a potentially important trade-off for development policy.

What evidence is there that RD might matter in poor countries? The literature contains some clues on the possible importance of relative deprivation. Drawing on village-level observations, Rao (2001) argues that perceptions of 'status and rank' matter in rural India. Some of the qualitative reports from field work found in Narayan and Petesch (2002) are also suggestive of concerns about status and position.[5] While such field studies can be insightful, they offer no guidance on the quantitative importance of RD, and they contain ambiguities about even its qualitative importance relative to other factors.[6]

However, some other evidence points in a different direction, suggesting how poor people might share in economic gains to friends and neighbors. Given the uninsured risks facing poor people, and the prospects of falling into permanent destitution, various arrangements exist for mutual support or risk-sharing, and these have received much scrutiny in the development literature.[7] Gains to friends and neighbors will be shared up to some limit, as determined by the point at which the donor defects from the risk-sharing arrangement (Coate and Ravallion, 1993). Communities can also be important institutions for providing employment and local-public goods—generating positive externalities for the poor in relatively well-off areas.[8] Positive externalities can arise via one's current income or be an independent effect, such as through greater personal security in the presence of uninsured risks. Since it is repeated interaction that facilitates both social comparison and mutual support or collective action, it is not surprising that these conceptually distinct theoretical perspectives point to similar social groups—neighbors, friends, co-workers—as the generators of the external effects.

Not all the evidence has supported the idea of RD. Senik (2004) and Kingdon and Knight (2004) test for social effects in self-reported happiness in Russia and South Africa respectively. Their methods closely follow those found in the literature for developed countries, by which self-reported "satisfaction with life" (*SWL*) is regressed on "own income" and mean income for the area of residence (or mean income conditional on a vector of characteristics including location). In marked contrast to the developed-country literature, both studies found evidence of *positive* external effects of "neighbors' income," rather than the negative effect predicted by RD.

This paper provides direct tests for RD in one of the poorest countries, Malawi. Almost 90% of Malawi's population lives in rural areas, where the vast majority of households are small-holders who depend heavily on rain-fed, highly risk-prone and seasonal, traditional agriculture.[9] In the late 1990s, two-thirds of the population lived below the country's poverty line (National Economic Council, 2000). Income inequality is relatively high, with a Gini index around 0.50 (World Bank, 2005a). As in any risk-prone and poor rural economy there are various forms of informal insurance and social assistance in rural Malawi. An example is the institution of *ganyu*, whereby households in current need are provided unskilled piecework in return for food or cash. *Ganyu* is more than a labor-market transaction; it is also a form of social assistance within communities, embedded in established and reciprocal relationships (Englund, 1999; Whiteside, 2000; Mtika, 2001).[10] This is clearly an important source of positive external effects for poor people, as long as they have better-off friends and neighbors to turn to. But is it more important than RD?

[4] For overviews of the evidence see Oswald (1997), Frank (1997) and Frey and Stutzer (2002); based on such evidence Frey and Stutzer assert that "There is little doubt that people compare themselves to other people and do no use absolute judgments" (p. 412). We cite a number of specific examples later, and we also point to a number of sources of bias in the existing tests.

[5] Writing about poor people in Nigeria, Narayan and Petesch (2002) claim that, "In addition to material deprivation, the people ... speak of lacking dignity, status, security and hope" (p. 107).

[6] For example, in the quote from Narayan and Petesch in the last footnote, it can be argued that 'security' is a positive external effect of higher group welfare, not a negative one, as in RD.

[7] Amongst others see Ravallion and Dearden (1988), Murgai et al. (2002), Ligon et al. (2002), Fafchamps and Lund (2003), Maitra and Ray (2003) and Cox et al. (2004).

[8] For an interesting perspective on the role of communities see Bowles and Gintis (2002). In a development context, see Mansuri and Rao (2004). Jalan and Ravallion (2002) find evidence of positive externalities for poor rural households living in areas with better-off neighbors (in southwest China).

[9] Broader discussions of poverty in Malawi can be found in Ellis et al. (2003) and Peters (2004).

[10] With reference to *ganyu*, Whiteside (2000, p. 2) writes that "Providing food in exchange for work may be as much a social obligation for those with food as a response to work needing doing."