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Inequality and happiness: are Europeans and Americans different?

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Abstract

We study the effect of the level of inequality in society on individual well-being using a total of 123,668 answers to a survey question about "happiness". We find that individuals have a lower tendency to report themselves happy when inequality is high, even after controlling for individual income, a large set of personal characteristics, and year and country (or, in the case of the US, state) dummies. The effect, however, is more precisely defined statistically in Europe than in the US. In addition, we find striking differences across groups. In Europe, the poor and those on the left of the political spectrum are unhappy about inequality; whereas in the US the happiness of the poor and of those on the left is uncorrelated with inequality. Interestingly, in the US, the rich are bothered by inequality. Comparing across continents, we find that left-wingers in Europe are more hurt by inequality than left-wingers in the US. And the poor in Europe are more concerned with inequality than the poor in America, an effect that is large in terms of size but is only significant at the 10% level. We argue that these findings are consistent with the perception (not necessarily the reality) that Americans have been living in a mobile society, where individual effort can move people up and down the income ladder, while Europeans believe that they live in less mobile societies.

Keywords: Inequality; Happiness; Income

1. Introduction

Most governments redistribute income, using both direct and indirect means. Even though this role of the public sector has increased vastly in the last few decades in all

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industrial countries, European governments are more heavily involved with redistribution than that of the United States. European fiscal systems are more progressive than in the United States and the welfare state is more generous in Europe, where the share of government in the economy is substantially larger than in the United States. For instance, in 2000 the share of total government spending (excluding interest payments) over GDP was about 30% in the US, versus 45% in Continental Europe. The share of transfers over GDP was about 11% in the US and about 18% in Europe, and more than 20 in Germany, Sweden and other northern European countries.[1] At the end of the 19th century, the share of transfers over GDP was less than 1% both in Europe and the US. It was about 6% of GDP in the US, and about 10% of GDP in Europe in 1960. The growth of transfers explains almost all of the increase in the size of government and the difference in the size of government between Europe and the US.[2]

If democratic governments redistribute so much, it must mean that a large fraction of the population favors these programs that are meant to reduce inequality. For a start, the "poor" should be in favor of redistribution, since they gain from it on net. However, this preference is mitigated by the fact that the poor of today may become the rich of tomorrow and they do not want to be the ones who will have to support redistributive schemes. Conversely the rich should oppose redistributions, but if they fear to become poor they may see redistributive policies as an insurance against future potential misfortunes. Therefore, social mobility should influence how forward looking individuals value redistributive polices.[3]

Beyond self-interest, however, inequality (which is often associated with high poverty rates) may be perceived as a social evil. That is, at least up to a point, even the net losers from redistributive schemes may favor them because they perceive poverty and inequality as social harms. In part, this may also be motivated indirectly by self-interest, to the extent that inequality breeds crime and threats to property rights. But, even beyond that, the observation (or perception) of poverty may negatively affect the welfare of the rich and their sense of fairness. The bottom line is that inequality must be perceived as a social evil especially in those countries with large redistributive programs.

In this paper, we explore whether and why inequality negatively affects individual utility even after controlling for individual income. We measure "utility" in terms of survey answers about "happiness". Some readers may feel uncomfortable using such a vague question like "are you happy?" for any useful statistical investigation. As we discuss below, however, a growing literature both in psychology and in economics successfully uses it, and the patterns observed in the answers to this question are reasonable and quite similar across countries. This gives us confidence in the significance of using such data to study inequality.

[1] For historical data on the growth of redistributive programs in industrial countries, see Tanzi and Schuknecht (2000). For a comparison of redistributive policies in the US and in Europe, see Alesina et al. (2001).

[2] See Alesina et al. (2001) for a discussion and comparison of the evolution of European versus American welfare states.

[3] See Benabou and Ok (2001) for a precise theoretical formulation of this idea and Alesina and La Ferrara (2000) for empirical tests.