



RESEARCH BRIEF

The **Environment for Development** initiative is a capacity building program in environmental economics focused on international research collaboration, policy advice, and academic training. It consists of centers in Central America, Chile, China, Ethiopia, Kenya, South Africa, Sweden, Tanzania, and the USA (Resources for the Future). Financial support is provided by the Swedish International Development Cooperation Agency (Sida). www.efdinitiative.org

Unobserved household differences have a significant impact on subjective well-being, a study shows in urban Ethiopia

YONAS ALEM

DRB 14-04, APRIL 2014

Economic growth in industrialized countries over the past few decades did not result in improved subjective well-being (SWB) of citizens. This finding, known as the “Easterlin Paradox,” is mainly a result of the fact that subjective well-being is a positive function of income but a negative function of relative position. Recognition of the impact of relative standing on well-being in the discipline of economics dates back to the times of Adam Smith and Karl Marx. The current paper builds on existing studies and investigates the impact of relative standing on SWB in households in urban Ethiopia using three rounds of data spanning a decade. The data set contains detailed information on comparisons of respondents with others, with oneself over time, and with anticipated changes in the future, which enables to compare the differences in the magnitude of the impact of these variables on SWB.

Ethiopia is one of the least-developed countries and has recently experienced rapid but inflationary economic growth that has had clear impacts on the welfare of the urban population. In this context, analysis of the impact of relative standing on SWB, applying reliable empirical models to panel data spanning a long period of time, provides an important opportunity to add to the growing stock of knowledge on relative position and SWB in developing countries.

A large proportion of the economic studies on SWB in general and those focusing on the impact of relative standing in particular come from studies undertaken in industrialized countries. Most of these previous studies that were conducted in other countries show that economic status and relative position are significant determinants of life satisfaction. Similarly, in urban Ethiopia, it was found that per capita income increases life satisfaction and relative poverty decreases it. However, there is a need to address unnoticed household differences, which, if not addressed, will overestimate the effect of income and relative position on SWB.

Key Points

- Economic status is a significant determinant of life satisfaction. However, there is a need to address unnoticed household differences.
- Comparison of one's own economic status with others and with oneself over time have significant effects on subjective well-being.
- Policies that target income distribution may have significant effects at both individual and community levels.

RESEARCH BRIEF

Unobserved Household Differences Have A Significant Impact On Subjective Well-Being, A Study Shows In Urban Ethiopia

Therefore, the analysis of the paper adds to the rapidly growing empirical evidence in developing countries on the determinants of subjective well-being in general and the impact of relative standing in particular. Following these studies, this paper hypothesized that, controlling for different times and places, household-level variables, and individual characteristics, economic well-being in both absolute terms (such as household income) and relative terms has a significant impact on the SWB of households.

The paper finds that comparisons of one's own economic status with others and with oneself over time have significant effects on SWB of respondents in urban Ethiopia. Respondents who believe themselves poorer than others in the community report a significantly lower level of life satisfaction than those who perceive themselves as belonging to a middle income group. Not only is the impact of relative poverty negative, but it is higher than the impact of one's own actual economic status. However, controlling for unobserved household differences reduces the impact of these variables significantly.

Consistent with previous findings in other developing countries, respondents who believed their living standard deteriorated over the past five years reported a significantly lower level of life satisfaction than those who believed that their living standard remained the same. On the other hand, the results show that those who believed that their living standard improved compared to five years ago reported a higher level of subjective well-being. As expected, compared to respondents who expect the future to be the same as the present, those who expect life to be better reported a higher level of life satisfaction and those with negative expectations reported a lower level. The magnitude of the change in the SWB was notable.

The results from the study also suggest that the respondents' personal characteristics - such as marital status, age and unemployment status - are important determinants of life satisfaction, as was found in studies of SWB in industrialized countries. Compared to married respondents, single, widowed, and separated individuals all report a lower level of life satisfaction. Correspondingly, characteristics of individual respondents play an important role, although life satisfaction-related questions were asked for the whole household.

Conclusion and Policy Implications

It is a challenge to policy makers when subjective well-being of citizens declines in the face of rapid economic growth. This calls for a detailed investigation of the pro-pooriness of the recent economic growth in the country. Policies that target income distribution may have significant effects at both individual and community levels. The study also documents striking differences when estimates are obtained without taking account of individual differences among households. This study is also valuable in that it uses panel data which shows changes over time for the same households. Given the rapidly expanding documentation of panel data in many developing countries, future research could shed light on the robustness of the paper's findings by using alternative panel data sources.

ABOUT THIS BRIEF

This brief is based on results from Yonas Alem, (2014), "Life Satisfaction in Urban Ethiopia: The Role of Relative Poverty and Unobserved Heterogeneity," Environmental Economics Policy Forum for Ethiopia, Addis Ababa. EFD-RFF Discussion Paper 14-04, Environment for Development (Efd), University of Gothenburg, Göteborg, Sweden. (The DRB series of research briefs is associated with the Efd Discussion Paper Series.)

FURTHER READING

Bookwalter, J.T., & Dalenberg, D. (2009). Relative to what or whom? The importance of norms and relative standing. *World Development*, 38(3), 345-355.

RESEARCH BRIEF

Unobserved Household Differences Have A Significant Impact On Subjective Well-Being, A Study Shows In Urban Ethiopia

Clark, A.E., & Senik, C. (2010). Who compares to whom? The anatomy of income comparisons in Europe. *The Economic Journal*, 120, 573-594.

Clark, A., Frijters, P. & Shields, M.A. (2009). Relative income, happiness and utility: An explanation for the Easterlin Paradox and other puzzles. *Journal of Economic Literature*, 46(1), 95-144.

Dolan, P., Peasgood, T. & White, M. (2008). Do we really know what makes us happy? A review of the economic literature on the factors associated with subjective well-being. *Journal of Economic Psychology*, 29, 94-122

CONTACT

Yonas Alem, (Email) Yonas.Alem@economics.gu.se, (Tel) +46 31 786 1371



EfD Center in Ethiopia, www.efdinitiative.org/centers/ethiopia
ethiopia@efdinitiative.org, Phone 251 11 552 3564 /550-6066. Fax 251 11 550-5588,
Environmental Economics Policy Forum for Ethiopia, (EEPFE), Ethiopian Development
Research Institute (EDRI). Blue Building, Near National Stadium, Office Numbers 401-409,
fourth floor, P.O.Box 2479, Addis Ababa, Ethiopia