

REFERENCE INCOME EFFECTS IN THE DETERMINATION OF EQUIVALENCE SCALES USING INCOME SATISFACTION DATA

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Abstract

We estimate household equivalence scales using income satisfaction data from the German Socio-Economic Panel. We extend previous studies applying this approach by taking reference income into account. This allows separating needs-based from reference effects in the determination of income satisfaction. We show that this adjustment helps to overcome a bias causing an overestimation of adults' and an underestimation of children's equivalence weights. Our results indicate that controlling for income comparisons completely eliminates the gap between equivalence scale parameters for adults and children found in other studies. Furthermore, the equivalence weight of children appears to be decreasing in household income.

JEL Classification Codes: I32, J13, D31

Keywords: equivalence scale, income satisfaction, relative income

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