ABSTRACT. This paper aims to contribute further research on the conceptualization of individual financial satisfaction as a particular domain of satisfaction with life as a whole. Based on the 2003 Survey on Living Conditions and Poverty for Andalucía (Spain) and using a self-reported measure of welfare, ordered probit models are used to analyze the extent to which individual financial satisfaction can be solely explained by income in absolute terms, or alternatively, by taking into account the importance of relative income in its two dimensions: (1) personal aspirations as individual’s adaptation to previous and future income levels (intra-individual comparisons), and (2) social comparisons as individual’s concern for her peer’s income (inter-personal dependency).

KEY WORDS: comparison income, external norm, financial satisfaction, income valuation, internal norm, reference group

JEL Classifications: D60, I30, I31

INTRODUCTION

Money (income) by itself is hardly chosen as a source of individual utility or happiness. As it happens with other things we may want in life, such as job security, status, or power, we do not want them for themselves, but rather as a mean to fulfill individuals’ needs and desires to make ourselves happier.

On the grounds of utility theory, increases in income are desirable from an individual’s perspective and, in general, we assume that individuals will do their best to maximize their utility given a particular financial situation. For that reason, the level of satisfaction derived from a given financial situation will eventually be an important determinant of individual happiness. Hence, as argued by Diener and Biswas-Diener (2002), financial satisfaction (FS) can be
seen as a “mediator” between income and happiness, since life satisfaction is influenced by many factors other than income, while financial satisfaction has income as a major input.

Research on financial satisfaction as a specific domain of satisfaction with life or individual happiness has been limited in economics. While some authors (for a review see Frey and Stutzer, 2002) have largely investigated the straightforward relationship between income (and its attributes) and happiness, others have claimed that happiness as a whole can be seen as an aggregate concept, which can be unfolded into individual satisfaction with different domains of life such as health, job and, of course, financial situation (Van Praag et al., 2003). The aim of this paper is to contribute further research on the conceptualization of individual financial satisfaction as a particular domain of satisfaction with life as a whole, providing empirical evidence to disentangle the effects of income and its attributes on this financial domain after accounting for personal heterogeneity. This is made possible with an unique dataset (Survey on Living Conditions and Poverty for Andalucía) that includes individual data on reported financial satisfaction, as well as income and income valuation measures. Specifically, we model individual financial satisfaction by estimating an ordered probit.

The main contribution of this paper in relation to previous work is thus the simultaneous inclusion of income aspirations in people’s utility function to capture both, the comparison of own income with own needs (accounting among others for aspirations and expenditures) and resources to produce this income (intra-personal comparison or internal norm), and their concerns for the difference among own income and relevant others’ (inter-personal comparison or external norm). In doing so, different specifications are presented to systematically test for several hypotheses of the importance of income in absolute and relative terms, on individual FS, specifically: (1) adopting the standard approach that FS solely depends on the reported household income; (2) assuming that individual FS is constructed from a bundle of income characteristics that includes not only income level, but the divergence between reported household income and individual’s income needs or saving ability (income adequacy index) and, as a new contribution, income stability and expectations for the future; and (3) assuming that FS further depends to a different extent on the position of household income with respect